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No. 112.

In the Supreme Court of the United States

OCTOBER TERM, A. D. 1937.

AETNA INSURANCE COMPANY, AGRICULTURAL INSURANCE COMPANY, ALLIANCE INSURANCE COMPANY OF PHILADELPHIA, ET AL., PETITIONERS,

vs.

BEN C. HYDE, SUPERINTENDENT OF THE INSURANCE DEPARTMENT OF THE STATE OF MISSOURI, RESPONDENT.

BRIEF FOR RESPONDENT.

North Todd Gentry,
Attorney-General,
State of Missouri,
Frank E. Jacoma,
John T. Barrett,
Attorneys for Respondent.

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VS.

BEN C. HYDE, SUPERINTENDENT OF THE INSURANCE DEPARTMENT OF THE STATE OF MISSOURI, RESPONDENT.

BRIEF FOR RESPONDENT.

STATEMENT.

On the 9th day of October, 1922, the Insurance Department of Missouri ordered a reduction in fire insurance rates of 10 per cent in accordance with Section 6283, R. S. Mo. 1919.

Petitioners filed suit in the Circuit Court of Cole County, Missouri, questioning such reduction, and

the case finally reached the Supreme Court of Missouri. There the reduction order was sustained and it was held that with the reduction in effect, petitioners would make more than a reasonable profit in the State of Missouri.

Petitioners complain in this court of the decision of the Missouri Supreme Court:

I.

That the court refused to follow their method of calculating profit and loss of fire insurance companies and adopted the method as contended for by the state. The testimony is overwhelming on this point in favor of the state. The Rating Act requires the calculation to be made as contended for by the State of premiums received, losses and expenses paid as distinguished from the erroneous method suggested by petitioners of premiums earned, losses and expenses incurred.

II.

Petitioners complain that the Missouri Supreme Court allowed the State to figure as an earning of petitioners the sum of $2,301,132 interest earnings on unearned premiums. In a suit filed prior to this reduction between the same parties, petitioners agreed that the State was entitled to consider such earnings and the testimony likewise is in favor of the State on this point and the opinion so clear that nothing can be added to it.

III.

Petitioners claim that the Missouri Supreme Court deducted the sum of $2,496,715 which they paid as excess commissions to their agents and brokers in St. Louis, which commissions were higher than paid in Kansas City or other cities in Missouri. No reason was suggested by petitioners why the rest of the state should be called upon to pay increased rates to support these brokers in St. Louis, and clearly the Missouri Supreme Court was right.

IV.

Petitioners complain of the ruling of the Missouri Supreme Court in holding that even though they did pay $628,123 premium war tax during the war, and within this period, that as such tax has been repealed and will not have to be paid by petitioners in the future, no consideration should be allowed for its payment. What the Supreme Court actually held was that inasmuch as this tax was repealed during the period and will not have to be paid in the future, it should not be considered in making rates for the future.

V.

Petitioners complain that the Missouri Supreme Court fixed 8 per cent as a reasonable profit upon the business of the test period and claimed that the fixing of such a rate was confiscatory. Yet this court has repeatedly said that a 6 per cent return to a utility is a reasonable return. Petitioners further state that they are required by the Missouri law to set aside a

certain reserve and that such reserves were not considered in arriving at this rate of earning. The Missouri statute does not require them to set aside this reserve, and they do not do so. They simply must have on hand a sufficient sum to protect the policyholders in order that if they do retire from business they may re-insure the business still on their books. The statute referred to is not a part of the Missouri Rating Act and has nothing to do with the making of rates as fully explained by the Missouri Supreme Court in its opinion.

VI.

Petitioners claim that the Missouri Rating Act as construed and applied by the Missouri Supreme Court is unconstitutional. Stipulation was entered into between the parties that the unconstitutionality of the Rating Act would not be urged, but petitioners claim that the construction given it renders it unconstitutional. This point was fully considered by the Supreme Court in its opinion and similar acts have been sustained in many states in the American Union.

VII.

Petitioners say that if any single point of attack made by them upon the reduction order is sustained, the order must fall. There is no merit in this contention because the court finds that $6,680,169 is an 8 per cent return for the test period. Also that the companies actually earned during the test period $8,681,964, or $2,000,000 more than a reasonable return, and with the war tax eliminated, the return would have been $9,-

310,087, or about 40 per cent more than what was conceded to be a reasonable profit. It therefore follows that these companies made from 2 to 3 million dollars more than a reasonable return and a reduction must be sustained, even though some of the smaller items are stricken out, which we insist should not be done.

VIII.

Petitioners state that while this court will accept the construction adopted by the Missouri Supreme Court of a Missouri statute, yet if the statute as construed and applied deprives petitioners of property without due process of law, then this court will reverse the judgment. With this statement we have no quarrel because no federal question is involved in the construction of the Missouri statute and this court will allow Missouri to construe its own statutes.

IX.

Petitioners state that the decision in the Missouri Supreme Court does not rest upon independent non-federal grounds. We disagree with petitioners on this point and suggest that a reading of the opinion will show that no federal question was decided adversely to petitioners, or that their federal rights were in any way infringed upon.

X.

Petitioners claim that not only questions of fact were passed upon by the Missouri Supreme Court,

but questions of law as well, and with this statement we have no quarrel. The court did not, however, pass upon any federal question because it was not necessary for a proper determination of the case, but the case was decided upon questions of Missouri law and questions of fact and no federal right of any kind was infringed upon.

XI.

Petitioners claim that they have substantial property in Missouri and that they are entitled to invoke the protection of the 14th Amendment. In support of this statement they claim their agency plants and good will in Missouri constitute property. The agency plants are owned by the agents. All supplies, like blanks, etc., are owned by the companies. The agents presumably have the good will of their neighbors in soliciting business for these companies, but there is no testimony of any real tangible property owned by these companies in Missouri. If, however, they do own tangible property in Missouri, it has been suggested that perhaps they are entitled to a return upon the value of their tangible property devoted to the use of the public in Missouri.

Every question raised in this court was expressly passed upon by the Missouri Supreme Court. We feel unable to add anything to that opinion. The record in this case supports the opinion of the Missouri Supreme Court and a careful reading of the record will show that the reduction order was a just and reasonable one, and that the insurance companies have made in the

past and will make in the future more than a reasonable profit in Missouri.

The Missouri Rating Act requires all fire insurance companies doing business in Missouri to file annual sworn reports regarding their business. On these reports the Superintendent ordered this 10 per cent reduction. During the trial of this case, after the reduction was ordered, the State offered testimony to show that the reports were false and unfair and finally, during this trial, petitioners were compelled in open court to admit that such sworn reports filed with Missouri were inaccurate, unfair, contained many duplications and were indefensible (R. 535-299-522).

The testimony was overwhelming that the earned premium method as contended for by petitioners during this trial for the first time in Missouri since the Rating Act became effective, was purely an arbitrary one and did not show the true experience of the companies (R. 495-496-497-505-506-2030-2031).

The Missouri Rating Act was prepared jointly by the insurance companies and the State and was satisfactory to both and no suggestion was ever made that any method should be considered for rate making purposes other than the method now contended for by the State of premiums received, losses and expenses paid (R. 2300-2305).

On this method now contended for by the State, petitioners applied for increases in 1915, 1919 and 1920 (R. 2836-2837-2838-2834-2744-2745-2746; Deft's Exhibit 2035).

The testimony shows, without contradiction, that fire insurance companies make three reports to Missouri each year as to their Missouri business: First, an underwriting report which shows their entire activities in Missouri, and they make this report on the basis adopted by the Missouri Supreme Court, of premiums received, losses and expenses paid; second, an annual tax statement for the purpose of showing the amount of taxes due, and likewise they make this report on the basis of premiums received, losses and expenses paid; third, an annual statement or financial statement of their business throughout the United States, containing, however, one page showing their business done in Missouri, and this page of such report is likewise on the basis of premumis received, losses paid and expenses paid (R. 2745-2746-2747-2748-2837-2839).

It has been said, however, by counsel for petitioners in this court, that such financial report as to the total business of these companies throughout the United States, as reported to Missouri, is on both the basis of premiums earned and premiums received, but the report, as to business done in Missouri, even on this financial report which has nothing to do with the making of rates, is on the basis of premiums received, losses paid and expenses paid (R. 2747-2837-2839).

In fact, since the Rating Act was passed, and up to the present time, every report filed with the Insurance Department of Missouri by these insurance companies has been on the basis of premiums received, losses paid and expenses paid (R. 2747-2837-2839).

In view of the fact that petitioners insist that this unfair method of theirs, adopted solely for the purpose of this lawsuit, is fair, how can it be explained that four of the best known presidents of fire insurance companies in the United States testified, unequivocally, that the method contended for by them, of premiums earned, losses incurred and expenses incurred, was absolutely impossible (R. 1146-1190-1191-1211-1293-722-263)?

It is true, some of the employees of petitioners testified that this erroneous method of theirs was fair and proper, but these men had been in the employ of fire insurance companies all their lives, and adopted this method because their superiors wanted it. They were partisans and believed what it was to their interest to believe. They were not unbiased witnesses but were exceedingly prejudiced. They adopted this theory solely because it worked to their advantage and to the disadvantage of the State (R. 502-120-125-215-216-424).

During the trial, these companies insisted they were entitled to an underwriting profit of from 5 to 10 per cent, with a 3 per cent allowance for conflagration liability, which they never attempted to set up as a reserve. However, they wanted this profit on their unfair and erroneous method of figuring profit and loss, and to allow them a 5 per cent underwriting profit on this unfair method used by them for the purpose of this law suit, would mean a return of at least 500 per cent to their stockholders (R. 895).

The uncontradicted testimony shows that for a period of 20 years prior to this reduction, the com-

panies generally, on this unfair and erroneous method, which they now insist upon, never earned as much as one per cent underwriting profit, and now to allow them 5 per cent on this unfair method would mean a return to their stockholders of more than 500 per cent, and mean an increase of the rates in this and other States to thus satisfy the unwarranted demands of petitioners (R. 1956-2894-2871-895).

The Missouri Supreme Court, in this case, *Aetna Insurance Company* v. *Hyde*, 285 S. W. 65, acquiesced in the return demanded, of 8 per cent, and reached the conclusion that an 8 per cent return, after the reduction was in effect, would mean, in dollars and cents, during this test period, $6,680,169, but that petitioners had actually earned $8,681,964, or 2 million dollars more than an 8 per cent return, and that with the war tax eliminated, which they will not have to pay in the future, they earned during this period $9,310,087, or, as the Supreme Court said, "About 40 per cent more than what was conceded to be a reasonable profit."

Petitioners are in error in stating that their profit is so close that the order must be set aside if they win on a single, solitary point. They made nearly 3 million dollars more than an 8 per cent return, and the opinion of the Supreme Court of Missouri is so clear and convincing that this court will have no trouble in agreeing with it. In fact, after analyzing the earnings of petitioners, this pertinent question is asked by the Supreme Court of Missouri, which we hope petitioners will answer in this court: "Was any business ever so generally prosperous? The plaintiffs, by

this showing, every five years can quadruple their original investment, or double their total accumulations, and at the same time pay as dividends 10 per cen per annum."

While the Missouri Supreme Court did not expressly approve petitioners' contention that they were entitled to a profit upon their volume of business, yet, as the court states, they made nearly $3,000,000 more than an 8 per cent profit on such method and for that reason it was not questioned. The state contended the proper way was to allow petitioners a reasonable profit upon their capital and surplus apportioned to Missouri in exactly the same way in which they apportioned Missouri expenses. It was not necessary to pass on this contention of the state, as on any theory they made more than a reasonable profit. We are quoting from the Kansas Supreme Court in an opinion not yet reported, which was handed down October 8th, 1927, wherein that court holds that petitioners are entitled only to a reasonable profit upon their capital and surplus apportioned to Kansas. This case is cited for what it is worth in order that this court may have the two different theories before it. On either theory petitioners made more than a reasonable profit in Missouri and the reduction order will have to be sustained.

No federal question of any kind is involved in this case and the suit should be dismissed. The Missouri Supreme Court construed the Missouri Rating Act as requiring profit or loss to be figured on the premium received method. On this method these companies made nearly $3,000,000 more than an 8 per cent profit during the period and no question of confiscation is

involved. The court also held that interest earnings on the unearned premiums should be considered by the state in accordance with the Missouri statute. This on the theory that petitioners have only one activity, the writing of insurance, and all of their experience must be considered. No federal question of any kind is involved in either of these matters, as respondent shows by many leading authorities from this court, and we respectfully insist that the suit must be dismissed and the judgment of the Missouri Supreme Court sustained.

Petitioners are in no position to attack the constitutionality of these Missouri statutes. They entered into a written stipulation (R. 26), "That in such matter the question of the constitutionality of Sections 6283 and 6284, Revised Statutes of Missouri, 1919, shall not be raised." They now say however, that they are not attacking the statute but attacking the construction placed upon it by the Missouri Supreme Court. The insurance department followed this statute and reduced rates. The Missouri Supreme Court sustained such reduction and said the insurance department was legally authorized to follow such statute. Now, apparently, petitioners construe this solemn stipulation to mean that if the courts construed the statute as they wanted it construed, they would not attack its constitutionality, but if the Supreme Court construed the Missouri statutes in favor of the State, they reserved the right to attack its constitutionality. The stipulation is not capable of this interpretation and petitioners should not, in this court, be allowed to repudiate their written stipulations.

POINTS AND AUTHORITIES.

I.

The Missouri Supreme Court rightfully held that for rate-making purposes the calculation of profit or loss of fire insurance companies can only be made upon the basis of premiums received, losses paid and expenses paid. Earned premiums, incurred losses and incurred expenses cannot be considered for rate-making purposes.

Aetna Insurance Company, et al. v. *Hyde*, 285 S. W. 65.
Section 6283, R. S. of Mo. 1919.
Section 6280, R. S. of Mo. 1919.
Section 6281, R. S. of Mo. 1919.

II.

The Missouri Supreme Court rightfully held that $2,301,132 interest earnings on unearned premiums should be considered for rate-making purposes.

Aetna Insurance Company, et al., v. *Hyde*, 285 S. W. 65.
Aetna Insurance Company, et al., v. *Travis*, Kansas Supreme Court, October 8th, 1927 (not yet reported).

III.

The Missouri Supreme Court rightfully held that $2,496,715 excess commissions gratuitously given insurance agents in St. Louis should be deducted as an operating expense.

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Arkansas Rate Cases, 187 Fed. Rep. 290.
Chicago & Grand Trunk R. R. Co. v. *Wellman*, 143 U. S. 339.
Nebraska v. *Adams Express Co.*, 85 Nebr. 25, 42 L. R. A. (N. S.) 396.
State v. *Virginia & T. R. Co.*, 24 Nev. 53, 49 Pac. 945.

IV.

The Missouri Supreme Court rightfully excluded $628,123 war tax on premiums during the war because said act was repealed after the war and the companies will not have to pay any such tax in the future.

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V.

The Missouri Supreme Court did not of itself fix 8 per cent of premiums received as a reasonable profit upon the business of the companies, but merely for the purpose of argument accepted such figure because requested so to do by the insurance companies. They have always insisted that they were entitled to a profit of 8 per cent and the state never questioned it because the profit actually received by them is so much more.

Aetna Insurance Company, et al., v. *Hyde*, 285 S. W. 65.
Section 6222, R. S. of Mo. 1919.

VI.

The Rating Act of Missouri is constitutional and this court has repeatedly held that fire insurance is impressed with a public trust and is a proper subject of regulation.

German Alliance Insurance Company v. *Lewis*, 233 U. S. 389, L. R. A. 1915, 1189.

National Union Fire Insurance Company v. *Wandberg*, 260 U. S. l. c. 73, 43 Sup. Ct. Rep. 32.
State ex rel. v. *Harty*, 278 Mo. l. c. 691.
Insurance Company of North America, et al., v. *Welch*, 49 Okla. 620, 154 Pac. 48.
Henderson v. *McWaters*, 104 S. C. 268.
German Alliance Insurance Company v. *Barnes*, 189 Fed. 769.
Martin v. *Howard*, 96 Nebr. 278, 147 N. W. 689.
People v. *Company*, 126 Ill. App. 636.
12 Corpus Juris, 850.
Aetna Insurance Co. et al., Appellees, v. *Frank L. Travis, Appellant* (decided Oct. 8, 1927, not yet reported).

VII.

Petitioners erroneously assume that if a single attack made by them is sustained, the opinion of the Missouri Supreme Court must fall. Such a statement is not in any sense accurate.

Aetna Insurance Co. v. *Hyde*, 285 S. W. 65.

VIII.

The decision of the Missouri Supreme Court construes the Missouri Rating Act and this court will follow the construction placed upon such act by the highest court of the state. Such construction does not to any extent deprive petitioners of property without due process of law.

Supreme Lodge, Knights of Pythias v. *Meyer*, 265 U. S. l. c. 32.
Des Moines National Bank v. *Fairweather, et al.*, 263 U. S. l. c. 105.
Hibben v. *Smith*, 191 U. S. l. c. 325.

IX.

No federal question is in any way involved in this case. The decision rests on independent grounds not involving a federal question, and although federal rights were asserted by these insurance companies, no consideration of a federal question of any kind was considered. It was not necessary to consider such a question and it was not considered.

California Powder Works v. *Davis*, 151 U. S. l. c. 393.

Eustis v. *Bolles*, 150 U. S. l. c. 366.

New Orleans v. *New Orleans Water Works Company*, 142 U. S. l. c. 84.

X.

Aside from the construction of Missouri Statutes, all other questions decided by the Missouri Supreme Court are questions of fact. This court will not undertake to review the decisions of the Supreme Court of Missouri on questions of fact.

Waters-Pierce Oil Co. v. *Texas*, 212 U. S. l. c. 97.

Smiley v. *Kansas*, 196 U. S. l. c. 453.

King v. *West Virginia*, 216 U. S. l. c. 100.

XI.

In ordinary rate reduction cases the utility is entitled only to a reasonable return upon the property devoted to the use of the public. If the agency plants of petitioners in Missouri constitute property as alleged, devoted to the use of the public, and have a value of $4,265,302 as alleged, then perhaps petitioners are entitled to a reasonable return upon such value.

Minnesota Rate Cases, 230 U. S. 352, 33 Sup. Ct. Rep. 754.

Wilcox v. *Consolidated Gas Co.*, 212 U. S. 19, 29 Sup. Ct. Rep. l. c. 195-199.

ARGUMENT.

I.

The Missouri Supreme Court rightfully held that for rate-making purposes the calculation of profit or loss of fire insurance companies can only be made upon the basis of premiums received, losses paid and expenses paid. Earned premiums, incurred losses and incurred expenses cannot be considered for rate-making purposes.

The Fire Insurance Rating Act was passed in Missouri in 1915. It was the result of an agreement with the officials of the state and the fire insurance companies. After such act became effective, the fire insurance companies several times applied for an increase of rates, and always applied upon the basis of premiums received, losses paid and expenses paid. The act as passed was satisfactory to the insurance companies and no suggestion was ever made that any method should be considered for rate-making purposes other than premiums received, losses and expenses paid (R. 2305-2300).

In the fall of 1915, these insurance companies applied to the State for an increase in rates and received same, using the method now contended for by the State and satisfactory to them at the time, of premiums received, losses and expenses paid (R. 2836-2838-2834).

In 1919 these insurance companies filed suit in the Cole County Circuit Court, called the "Surcharge" case, again asking for an increase in rates, using the

method of premiums received, as contended for by the State in this case.

Defts.' Exhibit 2035.

In January, 1920, the same insurance companies applied to the State and received from the State an increase of 15 per cent and used the method of premiums received as contended for by the State in this case (R. 2744-2745-2746; Deft.'s Exhibit 2035). Having received two increases by this method, it appears unfair for these same companies to now insist upon an entirely different method, solely for the reason that astute and trained accountants for the company have discovered a vast and unfair advantage for them in the use of the earned premium basis under an ascending scale of business. In short, in their very prosperity in Missouri is found a means of taking advantage of the policy holders of the State. Up to the time of the filing of this present suit, the companies never once contended in Missouri that the premium earned method was a proper method for rate-making.

All of the judges of the Missouri Supreme Court participating in this opinion agreed that the insurance companies were entitled to a reasonable profit upon the statutory and well-recognized method of calculation of premiums received, losses and expenses paid, as distinguished from premiums earned, losses and expenses incurred, and the opinion is so clear and convincing on this point that we desire to quote, believing as we do, that we are unable to add anything to it, and that it will, of necessity, be followed by this court. In this case, *Aetna Insurance Company* v. *Hyde*, 285 S. W. l. c. 70, in

discussing the claim of these insurance companies, that their profit or loss should be figured upon the basis of premiums earned, losses and expenses incurred, and in denying the same, the court said:

> "III. The difference in method appears in consideration of the premiums. The plaintiffs insist that unearned premiums shall not be considered at all in estimating the underwriting profits; that the way to estimate the profits which accrued during the test period is to take the earned premiums and deduct the losses and expenses incurred. The state insists that the proper method is to take the premiums collected and subtract the losses and expenses paid in order to ascertain the profit. This necessitates an inquiry as to what unearned premiums are and their effect.
>
> "(9) Unearned premium is that portion of a premium paid which must be returned to the insured on the cancellation of the policy, and is in direct proportion to the unexpired time during which the policy is to run. They are paid in advance for service to be thereafter rendered. That is, it is what a company must repay when it cancels a policy. As we understand it, it is not the short-rate payment which the insured received when he desires to cancel the policy. The fundamental error of the plaintiffs' method appears in several ways. Judge Ragland has written so clearly on that subject that we quote from his opinion as follows:
>
> "'As heretofore stated, it is the contention of the companies that the earnings of a given period on which underwriting profit can be predicated are determined by deducting from the premiums earned during that time the losses and expenses incurred. The method employed for ascertaining the amount of premiums earned is this: Add the unearned premiums at the beginning of the period to the aggregate net premiums received

during that time and deduct from the sum the premiums unearned at the end of the period. Incurred losses and expenses are arrived at in this way: Subtract the outstanding incurred losses and expenses at the beginning of the period from the losses and expenses paid during that time, and then add the losses and expenses unpaid and outstanding at the end of the period. According to the method of determining earnings just outlined, respondents lost during the period in question in their underwriting business $7,010,200. During the entire period their business was steadily expanding; the rate of increase being pronounced. As a consequence, the figure indicating unearned premiums at the end of the period was much larger than the one representing unearned premium at the beginning. Had those figures been transposed, that is, if the larger one had represented the unearned premiums at the beginning of the period, and the smaller one the unearned premiums at its close, according to the method of computing earnings just described, the companies would have had an underwriting profit of more than $9,000,000. To express it differently: When the companies are prosperous and increasing the volume of their business, according to this method of computing earnings, they are losing money. When their underwriting is falling off, they are piling up profit. It should not be forgotten that "unearned premium" is but an arbitrary measure of contingent liability. Such liability, while it necessarily increases with an expanding business, is by no means a true exponent of under writing earnings. An insurance accountant of many years' experience, testifying for respondents, stated that, while the fire insurance business had been rapidly increasing in volume during the last 20 years, the companies, according to the method of computing earnings which they now invoke, had during the whole of that time made an underwriting profit of less than one per cent. It was the witness' theory that the huge surpluses which they

have managed to accumulate during that time resulted from investment earnings, but it is unbelievable that corporations so organized for profit would have continued for such length of time to hazard their capital in the business of underwriting if that business in fact yielded no profit. The method of determining profit which respondents seek to have applied is clearly unsound.

"'In their bookkeeping the companies at the close of each year strike what their accountants term a trade balance. This balance is derived by deducting from the aggregate net premiums received during the year the total losses and expenses paid during that time. The net premiums consist of all premiums received less the *pro rata* returned upon cancellation and sums paid for reinsurance. When a loss occurs, an estimate of the amount is entered upon the books as an "incurred loss." When the loss is subsequently adjusted, it is paid. The amount paid is frequently reduced by salvage or recoverable reinsurance. But losses regardless of when they occurred are paid out of current premium receipts. The distinction between incurred expenses and paid expenses is negligible. All expenses, with the exception of taxes, are ordinarily paid within the year in which they are incurred.

"'The annual trade balance of a company engaged in a continuing business, being the difference between its receipts on the one hand and its expenditures on the other, during the preceding year, must necessarily reflect with a fair degree of accuracy its earnings for that period. To be sure, such balance would not be indicative of solvency as heretofore defined, nor would it properly represent net earnings if the distribution of assets upon dissolution were involved, but nevertheless it cannot be gainsaid that it does in fact constitute the clear earnings of the period embraced, if that period be considered apart from those which preceded it and those which follow, as is the case where a basis for rate regulation under the statute is sought.

"'Based on the conclusions reached in the preceding paragraphs, we are of the opinion that the "aggregate amount of * * * premiums, losses and expenses for or on account of business within this state * * * for * * * five years next preceding" intended by the Legislature were the aggregate net premiums received and the losses and expenses paid during the 5-year period. That is the construction which has been placed upon the statute by the insurance department of the state at all times since its enactment, and the construction which the plaintiff companies themselves have heretofore acquiesced in and acted upon in their application for increase of rates. The stand now taken by them has the appearance, therefore, of having been contrived by ingenious counsel, or by possibly more ingenious insurance accountants, for the purposes of this case.'

"The cost of procuring insurance is approximately 40 per cent of the premium paid. Now what happens? At the end of the test period all unearned premiums are deducted; that is, they are not counted as a part of the resources of the company accumulated during the test period. But the 40 per cent cost of procuring it is deducted. Thus the plaintiffs very naturally say that an unearned premium is a liability instead of an asset. It certainly is the way they figure it. Yet they have collected the unearned premiums; they have the cash in hand; the cost of procuring it has been paid or incurred; and it is subject only to the hazard of future losses, and possibly occasional cancellation. At the end of the period under consideration the unearned premium in the hands of all the companies amounted to $17,061,300. That was subtracted because not yet earned. But the cost of procuring it was also subtracted; that is, the gain on that much business could not be considered, but the expenses of it could be considered.

"Suppose on the last day of the test period the several companies had written insurance on which

the premiums were $100,000. That might easily be done, because they wrote nearly $20,000,000 worth in premiums during that year, being considerably over a million and a half per month. The cost of producing that, approximately 40 per cent, would be $40,000. Not $1 of those premiums could be counted as an asset in the profits, but the $40,000 cost must be deducted as an expense on other business done. Thus, if that $100,000 worth of insurance had been transacted the next day, it would have been a difference of $40,000 in favor of the state.

"They say that an unearned premium is worthless; yet they invest large capital in the business, spend a lot of money in equipment for transacting the business, and incur enormous expense in procuring and producing that unearned premium. Every premium on every risk that is written is unearned the moment the contract is entered into. Their entire business is conducted for the purpose of acquiring unearned premiums and nothing else. Unearned premiums are the total result of the whole underwriting business, and yet they say they are worthless. Even a person with no bookkeeping experience would say that, if this money which an insurance company has acquired in its business is not to be counted among the assets, certainly the expense of producing it ought not to be counted against the other business to be considered in the test. Their own figures show that the probable losses exceeded little or no more than 55 per cent of the premiums received.

"(10) These unearned premiums, then, are at least worth 45 per cent of their face, but the probable losses have already been deducted on other losses occurring during the test period. Something is said in the evidence about the Richard method of figuring underwriting profits. Instead of charging off all unearned premiums, Richard estimated that the probable losses to be paid on the risks represented by those premiums would be 55 per

cent thus estimating the unearned premiums to be worth 45 per cent of their face, and he added that proportion as a part of the earnings. That, at least, is more just than the method adopted by the plaintiffs, who discarded unearned premiums altogether. But even that is wrong, because it does not take account of the fact that losses occurring during the test period have been paid on policies written before the test period.

"(11) The companies argue that the solvency test must be applied; that is, the premiums must be valued only at what the company should realize on them in case it should cancel all the policies. The solvency test is no test at all. The assets of a going concern are never of the same value as the same assets would possess in the case of a forced liquidation. The companies do not have to cancel the policies; it is not to their interest to cancel them; and there is not a remote possibility that they would cancel them. The possibility that the insured would cancel their policies is so remote as to be negligible. The respondents have put forward a very convincing argument on another branch of the case that in estimating results in this case we should not consider mere possibilities nor resort to conjectures. That reasoning should be applied here.

"The referee, in holding with the plaintiffs in that matter, says that method of arriving at the earnings is not satisfactory. It is not only unsatisfactory; it is utterly indefensible. Any method which makes an asset a liability, turns a profit into a loss, shows a profitable business to be a losing business, and writes enormous gains for a long period on the books, cannot be correct on any principle.

"It is said that, taking the whole life of an insurance company, that method would 'wash out' in the end. It could never 'wash out.' Take any period during the life of a company, whether long or short, it would not be correct. It has been shown

that the 5-year period is not correct. For a 20-year period it was false. A one-year period would not turn out correctly, and at the end of a 50-year franchise it would not be correct, because the company would have been profiting by the error all through its life, and at the end of the period there would still be unearned premiums which would have to be liquidated in some manner.

"The $17,000,000 of unearned premiums remaining at the end of the test period here is not counted as an asset, but the cost of producing it, nearly $7,000,000, is deducted from the assets. That is offset to some extent by the unearned premiums added at the beginning of the period, amounting to about half as much as the unearned premiums subtracted at the end. The former may be balanced against the latter, and that would still leave in the neighborhood of $3,500,000 deducted as an expense at the end of the period without any reason for it whatever.

"The referee says the weight of the evidence shows that the method adopted by the plaintiffs is the correct one. Undoubtedly, since the respondents had to produce the evidence, they put forward the most skilled accountants in the country to swear that such was the way their several companies kept their books for rate-making purposes. It seems to us that the method is supported by the weight of expert skill in managing statistics, skill in summoning phantoms, and in making realities vanish.

"(12) The method for ascertaining profits contended for by the state is to take the premiums actually received, and subtract the losses and expenses paid during the test period. The companies themselves have approved the method. If it is faulty, they cannot complain because their accounts afford no other way. It is the way other lines of business estimate their profits. The 5-year period is taken by the Legislature, presumably on the theory that the period will fairly reflect the

character of business done during the entire life of the corporation, at least of the aggregate business of all the companies."

Two of the judges of the Missouri Supreme Court dissented on one point alone in the Hyde case, *supra*, but even went farther than the majority opinion in sustaining the state on the proper method of calculation, and Judge Ragland, speaking for the minority, and in stating that this erroneous method of premiums earned was injected into this case apparently for the sole purpose of trying this one lawsuit, at page 81, said:

"'Based on the conclusions reached in the preceding paragraphs we are of the opinion that the "aggregate amount of * * * premiums, losses and expenses for or on account of business within this State * * * for * * * five years next preceding" intended by the Legislature were the aggregate net premiums received and the losses and expenses paid during the five-year period. That is the construction which has been placed upon the Statute by the insurance department of the State at all times since its enactment, and the construction which the plaintiff companies themselves have heretofore acquiesced in and acted upon in their application for increase of rates. The stand now taken by them has the appearance therefore of having been contrived by ingenious counsel, or by possibly more ingenious insurance accountants, for the purposes of this case. On the basis of premiums received and reported losses and expenses paid the companies earned during the test period in question an underwriting profit of $3,341,124, or four per cent of the aggregate net premiums.'"

The Missouri Supreme Court could not have held otherwise because numerous witnesses for these insurance companies testified that the method now contended for by them of premiums earned, losses and expenses incurred, was inaccurate, uncertain, and used solely for the purpose of securing the result contended for by them in this case.

The following witnesses testified for the insurance companies, and in effect stated that the method now contended for by these insurance companies could not be used for rate-making purposes:

Witness Toles, R. 120-125.
Witness Hendele, R. 215-216-428.
Witness Bush, R. 310-311-312-306-307-317-318.
Witness Groth, R. 502-503.
President Jamieson, R. 1145-1146-1171-1172.
President West, R. 1190-1191-1192-1211-1212.
Vice-President Buswell, R. 1293.
President Lane, R. 722-754-755.

We have shown beyond any question of a doubt that a reserve may be set up and maintained as well under the premium received theory as under the premium earned theory. In fact, it can be more successfully maintained under the state's theory. However, petitioners say two or three times throughout their brief that no consideration is given to the fact that in common practice 20 to 25 per cent of all premiums received are ultimately returned to policyholders on cancellation. This statement is true, but not in any sense involved in this case. During this trial petitioners offered the testimony of each company showing its experience in Missouri. Such experience deducted reinsurance and also cancellations.

The result was that such companies therefore reported in this case their net income, from which of course they had deducted within this period all cancellations. It is true perhaps that during the last year of this experience (1921) they wrote policies which may be cancelled outside of the test period, or in 1922 and 1923. Yet it must be remembered that inasmuch as this test period started January 1st, 1917, obviously some business written by them in 1915 and 1916, before the period, was cancelled in 1917 and 1918, within this period, and they paid this money back to the policy holders, although the state received no credit at all for the original premiums received by them before the period. Obviously, cancellations are not in any sense involved in this case. The testimony shows without contradiction that while about 20 per cent is returned to the policyholders by way of cancellations, nearly all of this is returned during the first year and very little returned after that. The matter evens itself up by the state being compelled to pay and return cancellations on policies written before the period, and that is what the Missouri Supreme Court means when, in its opinion, it said:

> "The companies argue that the solvency test must be applied; that is, the premiums must be valued only at what the company should realize on them in case it should cancel all the policies. The solvency test is no test at all. The assets of a going concern are never of the same value as the same assets would possess in the case of a forced liquidation. The companies do not have to cancel the policies; it is not to their interest to cancel them; and there is not a remote possibility that they would cancel them. The possibility that the

insured would cancel their policies is so remote as to be negligible. The respondents have put forward a very convincing argument on another branch of the case that in estimating results in this case we should not consider mere possibilities nor resort to conjectures. That reasoning should be applied here.

The referee, in holding with the plaintiffs in that matter, says that method of arriving at the earnings is not satisfactory. It is not only unsatisfactory; it is utterly indefensible. Any method which makes an asset a liability, turns a profit into a loss, shows a profitable business to be a losing business, and writes enormous gains for a long period off the books, cannot be correct on any principle."

Petitioners contend that for the purpose of paying taxes to the Government they were allowed to report their earnings on the basis as now contended for by them. We assume the Government had a right to require them to report their earnings on any method it desired, and we also contend that Missouri had the same right. Missouri required them to report their earnings on the basis of premiums received, losses and expenses paid, for the sole purpose of making rates. The Government allowed them to report their earnings on the basis of premiums earned, losses and expenses incurred for the purpose of collecting income taxes. The Government's theory may be right as to taxes, because ultimately it is assumed the Government will collect the taxes. It therefore makes very little difference perhaps to the Government whether it collects taxes in one year or another year. However, it is very important where you have a limited test period that it be ascertained the exact amount of in-

come and outgo of these petitioners. The Government was not interested in securing its taxes in any particular year, but probably thought it would receive them as time went on. For rate-making purposes, however, the method used for the collection of taxes cannot be used. It is unfair and indefensible. During prosperity and while the business of petitioners is increasing their method will always show a very small profit or a loss. However, during adversity and when the premium volume falls, their method will always show an abnormally large profit. A method which shows a loss during prosperity and a great earning during adversity cannot be sound, as explained by the Missouri Supreme Court.

In addition to citing the taxing federal statute petitioners cite the Arkansas case, *Bullion* v. *Aetna Insurance Company*, 131 Ark. 519. That case is not in any sense an authority for the reason that it involved a construction of the Arkansas Statute, which is entirely unlike the Missouri Statute. They also cite the English case, which was a tax case, *Sun Insurance Office* v. *Clark*, App. Cas. L. R. 1912, p. 443 (House of Lords). That case is not in any sense an authority and it appears that petitioners so stated before the Kansas Supreme Court recently, because in the opinion handed down by that court October 8th, 1927 (not yet reported) it is said:

> "It is worthy of note that plaintiffs (petitioners) since the filing of the former opinion no longer contend that *Sun Insurance Office* v. *Clark* (1912) A. C. 443, supports their contention that in computing profits of an insurance com-

pany unearned premiums should be disregarded —it seems clear that what was decided in that case had been misinterpreted."

II.

The Missouri Supreme Court rightfully held that $2,301,132 interest earnings on unearned premiums should be considered for rate-making purposes.

The reduction order in question was made in October, 1922. In 1919 these insurance companies asked an increased rate from the Missouri department, and upon being refused, filed a proceeding to compel the granting of such increase. They admitted at that hearing that the state was entitled to consider interest earnings on the unearned premium reserve, but not on capital and surplus. The Missouri Supreme Court simply follows their statements and agreements at that time, and it is so clear and convincing that we desire at this point to set it out. In *Aetna Insurance Company* v. *Hyde*, 285 S. W., l. c. 73, in speaking of the interest earnings on unearned premiums, the court said:

"(13) IV. The state claims and the insurance companies deny that interest on unearned premiums should be accounted for as part of the underwriting earnings of the companies. This amounted in Missouri during the test period to $2,301,132. That is the sum stated by the defendant's counsel, and is somewhat smaller than the sum mentioned by the referee, but the difference is not important. It is greater, as noted in paragraph II, than the interest on capital and surplus.

"The referee quite lucidly discussed this subject. He pointed out that insurance companies have for investment their capital stock; their surplus; their underwriting receipts; and receipts

from investments on these various funds. He then made this comment:

"'As to earnings arising from the investment of under-writing earnings, it is to be remembered that these underwriting profits or earnings are the net fruit to the insurance companies of their underwriting activities.'"

"He said further of the unearned premiums:

"'This money is paid in advance by the policy holders, and, until it becomes earned premiums or is refunded because of cancellations, it is required to be held by the companies in large part as a reserve fund. This fund is not available for distribution in the form of dividends, and in a sense is held by the insurance companies in trust for the policyholders. It does not belong to the policyholders, it is true, but it is equally true that it has not yet become the absolute property of the plaintiffs. It is at all times possible for the policyholders to withdraw the entire fund from the insurance companies by canceling their policies. This fund is kept invested by the plaintiffs, and a very considerable income is derived therefrom.'"

"This is the conclusion of the referee from the evidence produced. The last sentence is a finding of fact.

"The plaintiffs have a great deal to say about investment earnings, and they attempt to class all investment earnings together as having nothing to do with the underwriting business, but the tabulations show that the investment earnings are of two kinds: The earnings arising from the investment of capital and surplus, and those arising from the unearned premiums. We have taken account of the earnings arising from the investment of capital and surplus in paragraph II above, and refuse to allow that as a part of the underwriting profit for which the insurance companies are accountable for rate-making purposes.

"As the reports show, the companies had on hand at all times during the 5-year test period

very large sums received in Missouri as unearned premiums, ranging from about $10,000,000 at the beginning of the period to more than $17,000,000 at the end of the period, averaging over $12,000,000 in hand all the time. This money, as the referee finds, was invested and earned profit. The amount given as the earnings, $2,301,132, shows that it was kept well invested, and earned as much in proportion as capital and surplus. The capital and surplus allotted to Missouri was a little over $54,000,000, or an average of something less than $11,000,000 per annum.

"Notwithstanding those book figures, the plaintiffs reason that there is no such thing as interest on unearned premiums; that, in fact, it cannot exist. The argument by which they arrive at that conclusion is extremely ingenious, and is characterized by shrewd avoidance of patent facts. As we understand it, it amounts to this: In order to have interest on a fund, there must be a principal sum and a term of time in which that sum is in existence. No unearned premium continues the same for any appreciable time. From day to day or month to month it ceases to become unearned premium and becomes earned premium. It diminishes by the process of attrition, as the referee aptly says. The unearned premium is gradually worn away, and washed into the volume of earned premium. Therefore, if $1,000 of unearned premium were loaned out at interest today, there would not be $1,000 of that unearned premium tomorrow, but it would grow less and less, until perhaps, when the loan became due, it would all be earned premium, and you could not segregate that part of the interest which accrued on the unearned portion from that part which accrued on the earned portion. Therefore, the earned premium 'reserve,' so called, is a myth. Plaintiffs' counsel then argue that—

"'The division of premiums into earned and unearned premiums is a rational division, not of the proceeds of premiums from policy holders, as

our learned opponents assume, but a bookkeeping division used as a means of segregating an income period.'"

"Thus we are informed that the separation of the income from earned and unearned premiums is a bookkeeping fiction.

"The answer to that argument seems plain enough. The companies have had, at all times during the test period, millions of dollars on hand constituting the unearned premiums. In Missouri it has averaged more than $12,000,000. If a dollar of unearned premium ceases to become such, and becomes a part of the earned premium, another dollar of unearned premium is paid in. As the fund at the one end is worn off by attrition, it is increased at the other end by accretion, so that the fund remains practically intact, and continually earns profit. Because you cannot put your finger on the particular dollar that earns the interest, there is no interest on the fund of which it is a part, though each dollar removed from it is replaced by another dollar just as good. It would be just as logical to say that the United States standing army could not fight because its soldiers are gradually killed off or discharged and replaced by efficient recruits, so that in a generation none of the original solders remain.

"By what sort of reasoning can it be separated from underwriting earnings? As the referee has found, it is not distributable as surplus. Though the money is in possession of the companies, it cannot be declared in dividends to the stockholders. Common sense and common reason would conclude that, the premium being unearned, if it grows, the accretion is unearned. But, whether the interest become the absolute property of the companies as soon as it accrues or not, it is a profit directly from the earnings of the underwriting business, and not from investments of distributed or distributable funds.

"The plaintiffs present an elaborate argument to show that the unearned premium does not be-

long to the policy holders, but is the property of the companies, that it is not a debt to the policy holders, nor held in trust for them. It is retained to provide against contingent losses. In that same connection the plaintiffs say that the segregation of the unearned premium is a separation of the unearned premium is a separation of the surplus into a distributable and nondistributable surplus; that is, the unearned premium is not distributable, while the earned premium is distributable. If the earned premium remains in the surplus, its earnings would pass to the credit of the investment side of the corporation activities. But, as long as it is not distributable, it cannot be said to be surplus at all. If, from the time it is paid until it may be distributed, it grows by additions of interest, the increase goes with the principal as a part of the underwriting profits, just as the interest on a note is part of the debt represented by the note.

"In this connection it must be remembered that the plaintiffs have argued very forcibly on another point that unearned premium is not an asset at all but a liability; that the company did not own the unearned premium at any time, but held it subject to the contingency that it might be demanded. Thus the insurance companies own the unearned premium for the purpose of claiming on it as a part of the investment income, and they do not own it for the purpose of accounting for it as a part of the underwriting earnings. It is an underwriting liability for one purpose and an investment asset for another purpose. It is a profit for the purpose of attaching it to the surplus, but it is not a profit for rate-making purposes. The interest does not exist because you cannot designate the particular premium which earns the interest, but you can segregate the principal for the purpose of calling it an investment of funds owned by the companies.

"It is suggested that we cannot count the unearned premiums as underwriting profit, unless

it is absolutely owned by the insurer. It is therefore argued that we cannot count the interest on the unearned premium as underwriting profit, because that, in effect, would be compelling the insurer to pay interest on its own money to the insured. The argument thus assumes that no funds owned by the insurer, no matter how acquired or how used, can earn a profit which can be attributed to the insurance business, and that the policy holder must own the money used in the insurance business before the earnings of it can be called underwriting earnings.

"We are not taking an account between the insurance company and the policy holder; we are trying to find out how much the insurer profits by its insurance business. The insured pays his premium, and has no further claim on that specific money, but he holds a contract which the insurer must perform, and, if it holds that unearned premium for the purpose of securing performance, is it not used in the underwriting business?

"(14) The insurance company, at its organization, has the contributed capital of its stockholders. What income it receives by investment of that fund does not come from the underwriting business. That fund, as shown above, is increased from time to time by its own earnings, and by appropriations from the distributable surplus arising from the underwriting business. At what point do the underwriting earnings become investment surplus? Certainly not until they cease to be used directly in the underwriting business, and become distributable assets. Much is said about the reserve which an insurance company keeps on hand to meet the payment of losses and expenses. The evidence justifies the conclusion that this fund practically coincides with the unearned premiums. While it is invested and draws interest, it is no part of the investment fund. It is invested merely to safeguard it until it is needed, or until it becomes distributable. The plaintiffs

do not class it with their other invested funds. It is used in the underwriting business, and the interest on it is a part of the profit of that business.

"Suppose a judgment is rendered on an insurance policy, and the company sets aside a sum sufficient to meet the judgment. The company appeals the case, and the judgment after 3 years, is affirmed. The company pays it with interest accrued on it out of the money set aside for the purpose, which in the meantime has drawn interest, so that it exactly satisfies the judgment. According to the plaintiffs' argument, the interest on the judgment would be an underwriting loss, while the interest or money set aside to pay it would be an investment profit. Common sense would say that the fund is used in the underwriting business, and the interest accruing on it is attributable to that business. The entire unearned premium reserve is in that exact position. What it earns while it is used in the underwriting business is underwriting profit.

"It is manifest that, if premiums were paid after the services were rendered, instead of in advance, the rate would have to be increased, not only to meet interest on the deferred payment, but also to recover losses from failure to collect. In that case there would be no unearned premiums, but the increased rate would make such a difference in the sums received that it would be a mere conjecture as to how the 5 years' accounting would compare with present conditions. Taking all respondents' arguments on the subject, the ultimate logical conclusion is this: There never can be any underwriting profits. For no premium can be counted as profits before they are earned. After they are earned, they go into the investment surplus, and cannot be counted as underwriting profits.

"After all, however, we may reason about the character of unearned premiums and interest on them, the statute settles the matter.

> "Section 6281, R. S. 1919, required each of them to report to the superintendent 'the total amounts of its earnings on earned premiums.' Defendants assert, and plaintiffs do not deny, that the Rating Act containing that provision was the joint creation of the state insurance department and the insurance companies. It was satisfactory to them at the time. Why put it in the law, if the superintendent was not to consider it in making rates? Why embody in the statute a recognition of a phantom, a requirement to furnish evidence of something which does not exist? We regard that statute as a legislative determination that interest on unearned premiums is an underwriting profit, for the legislative body had no concern about any other kind of profit."

However, petitioners say before this court that insurance companies have two separate activities; underwriting and investment. This was fully presented to the Supreme Court of Missouri, and fully answered. Insurance companies are chartered to do a fire insurance business, not a banking business, and the Supreme Court of Kansas, in an opinion filed October 8, 1927, not yet reported, between petitioners and the State of Kansas, regarding a rate inquiry in that state, *The Aetna Insurance Company, et al., appellees, v. Frank L. Travis, Superintendent of Insurance of the State of Kansas, appellant*, discussed the matter so fully that we desire to support the opinion of the Missouri Supreme Court with its opinion. The Supreme Court of Kansas said:

> "Turning our attention to the next question: (2) In determining the income of plaintiffs should consideration be taken of their investment earnings? Plaintiffs contend their investment earn-

ings are entirely independent and distinct from underwriting profits and should not be included in their gross income for rate-making purposes. We are unable to see merit in this contention. No reason suggests itself why the business of insurance should not be regarded as a whole. So far as the real owners of the business, the stockholders, are concerned, all income arising from the business, and all expenses and loss incident thereto, should be considered, and must of necessity be considered in determining whether or not there has been a profit, and the extent and amount thereof. Defendant contends R. S. 40-214 requires income from investment to be considered. By R. S. 40-111, 40-113, 40-206, it is clear that investment earnings are regulated and safeguarded. In estimating profits for the purpose of declaring dividends unearned premiums are required by statute to be reserved. This requirement is primarily in the interest of solvency, as will be later discussed. Plaintiffs call our attention to the Minnesota Rate Cases, 230 U. S. 352, and allied cases, which hold, in substance, that assets and property of a public utility not devoted to public service cannot be considered as a basis of rate-making. The rule is sound in reasoning and is sustained by an array of authority. The difficulty of applying the doctrine of these cases of stock fire insurance companies, and especially to the case before us, is that there is no showing that the capital or surplus of plaintiffs, or any part of it, is not used in the insurance business. In fact, the testimony from each of the officers of plaintiffs who testified upon the subject is that capital had been increased from time to time and the surplus had been, in part, retained and not disbursed to the stockholders because it was advantageous to plaintiffs in the insurance business. It is argued that separate employees, and in some instances separate officers of the company, devote their time to investment while others give attention to the under-

writing. This is not a reason for regarding the businesses as separate. In any large business no one person can transact all of it. The fact that some employees or officers devote their time to a particular part of the business rather than to another is no indication that all of it is not a part of the insurance business as a whole. Plaintiffs speak of the banking end of their business. In a series of decisions, years ago, the distinction between the insurance business and the banking business was noted, and it was held the one did not embrace the other (*New York Fire Ins. Co.* v. *Ely*, 5 Conn. 560; *The Aetna Nat. Bank* v. *Charter Oak Life Ins. Co.*, 50 Conn. 167, 183; *Blair* v. *Perpetual Insurance Company*, 10 Mo. 559; *Ohio L. I. & T. Co.* v. *Merchants', etc., Co.*, 11 Humphrey 1 (Tenn.); *Life Association of America* v. *Levy*, 33 La. Ann. 1203; *Huter* v. *Union Trust Co.*, 51 N. E. 1071 (Ind.); *Myers* v. *Mutual Life Ins. Co.*, 153 Ind. 204; *Robotham* v. *Prudential Insurance Co.*, 64 N. J. Eq. 673; *National Bank of Washington* v. *Insurance Co.*, 41 Oh. St. 1).

"In *Memphis* v. *Memphis City Bank*, 91 Tenn. 574, the court held that a corporation entitled the 'Memphis City Fire and General Insurance Company,' whose officers are authorized to write insurance of various kinds, 'and generally to do all things necessary and proper in carrying on the general insurance business,' is not empowered to do a banking business, although its charter provides that it may purchase, hold and convey any and all kinds of estate, real, personal, or mixed, receive in trust money or other valuable things, and loan surplus funds on any stocks of any incorporated company, or of the United States, or 'invest them in any real or personal estate, or choses in action, or other good securities.'

"And, on appeal of that case to the United States Supreme Court, 161 U. S. 186, touching the claim of the company that it had, by legislative authority, changed its business from an insurance

business to a banking business, and was then entitled to certain exemption from taxation which it enjoyed while conducting an insurance business, the court said: 'We think the change from the business of insurance to that of banking is a material and radical change,' and denied the contention.

"Plaintiffs are not incorporated as, and do not have the functions of, banks. They are insurance companies, required by law to have a capital and surplus with which to conduct their business; and all of their business transactions, their underwriting and their investments, are supervised and regulated for the common good, because the business as a whole is one clothed with the public interest (*German Alliance Ins. Co.* v. *Kansas, supra*). In the case of *Aetna Ins. Co.* v. *Hyde, supra*, it was held that the income from investments representing capital and surplus should not be considered, but the income of investments representing unearned premium should be considered. Upon this point there was a division of opinion among the members of the court.

"It may be noted that since the controversy in that case arose the Missouri legislature enacted a statute (act approved March 21, 1923, amended Sec. 6283, Rev. Stat. 1919) requiring the Superintendent of Insurance, in determining the question of rates and profits, to take into consideration, among other things, 'all earnings of such companies, including investment profits.' While we agree with the Missouri court that income from investments from unearned premiums should be taken into account, we are unable to see a good reason for not taking into account income from investments of capital and surplus. All of it is income for the companies; it is a part of the insurance business, and should be considered together with income from premiums, and any other income of the business. It was error for the court below to disregard income from investments.

"Passing to the next question: (3) Upon what principle should underwriting profits be computed; or, as may be otherwise stated, what premiums shall be considered and what losses and expenses shall be considered in determining the underwriting profits of plaintiffs? Since we have already determined that rates should not be based on underwriting profits only, but should include a consideration of all the income and all expenses and losses, this question becomes of secondary importance; but a brief discussion of it may be helpful. In *Ballou* v. *Aetna Insurance Co.*, 151 Ark. 519, decided under a statute which required premium rates to be determined by the 'underwriting profits,' the definition of that term was important; but, as previously pointed out, that is not true under our statute, which does not use the term 'underwriting profits,' but which makes the reasonableness of the order affecting rates the only test. On this branch of the case it is not necessary to elaborate extensively what was said in the former opinion (121 Kan. 802, 805-811, 257 Pac. 337). One correction should be made. It was there stated: 'Incurred losses and expenses * * * average, from year to year, from 10 to 12½ per cent more than losses and expenses annually paid.' While the evidence as to some of the plaintiff companies showed the difference to be that great, considering all the plaintiffs, the difference is not so much. We adhere to the view, previously expressed, that in determining the profits of plaintiffs, losses and expenses should not be computed substantially greater than they are. Since the filing of the former opinion a great deal has been said in the briefs and oral arguments with reference to premium receipts, as there discussed; but the question, what profit the premium receipts yielded, is still unanswered. The real difficulty with plaintiffs on this branch of the case is this: After having persuaded the referee and the court below to disregard the value of the capital used in

the insurance business (properly allocated to this state) as the sum on which they are entitled to make a reasonable profit, and to disregard income from investments required by statute to be made by them in conducting the insurance business—both of which conclusions we have now determined to be erroneous—and having the inquiry as to their profits limited to premium receipts, less losses and expenses, they have failed to show what has become of all the premium receipts; what profit, if any, resulted from premiums received. If profits of plaintiffs are to be computed from the 'underwriting business' alone, the method pursued is not important. All that is required is that it be some accurate method, and that it be complete.

"The method used by plaintiffs in this case was both inaccurate and incomplete. It was inaccurate in the one respect, at least, of computing losses and expenses substantially greater than they were. It was incomplete in that it did not show what part of the premiums ultimately became profit. The result is that there is a fatal hiatus in the proof. It must be remembered that the gist of plaintiffs' complaint in this action is that the order made by defendant, sought to be enjoined, so reduced rates that plaintiffs were unable to make a reasonable profit. How is it possible to establish that fact without showing what part of the premiums, if any, ultimately became profits? Obviously, such a showing is essential. The order made by defendant is presumed to be reasonable—to be one that would enable plaintiffs to make a reasonable profit in the conduct of their business. The burden was on plaintiffs to establish their allegations that it was unreasonable and confiscatory. They failed to make that showing. It is worthy of note that plaintiffs, since the filing of the former opinion, no longer contend, that *Sun Insurance Office* v. *Clark*, (1912) A. C. 443, supports their contention that in computing profits of an insurance company unearned premiums

should be disregarded—it seems clear that what was decided in that case had been misinterpreted. It is contended, however, that the Bullion case (*Bullion* v. *Aetna Insurance Co., supra*) is an authority for such holding. As previously noted, this case turned on the interpreting of the state statute. The court even took evidence of the author of the bill and of the ideas he had in mind as to the meaning of the language used, and followed what it found to be the legislative intent. The statute differs from ours. The case is neither controlling nor persuasive here."

Two judges of the Missouri Supreme Court dissented on this point alone. Otherwise the opinion was unanimous. All of the judges held the method adopted for figuring profit and loss by the insurance companies was erroneous and unfair. All of the judges held with the State on every point except whether or not the sum of $2,301,132 interest earnings on unearned premiums should be charged against insurance companies and their income increased that much. Obviously the dissenting judges overlooked Section 6281, Revised Statutes of Missouri, 1919, as pointed out in the majority opinion on this point. Under that section insurance companies in Missouri were required to report to the Superintendent "the total amount of its earnings on unearned premiums." The opinion, however, when printed, uses the words "unearned premiums" instead of the language of the statute, "unearned premiums." This section, as stated by the Supreme Court, either has a meaning or it has none. If any meaning at all, it means that the insurance companies must report their earnings on unearned premiums. The allowance to the State was

made on their earnings on unearned premiums as required by the statute. The State would not have required insurance companies to report their earnings on unearned premiums if they were not to be considered by the State for rate making purposes. The Rating Act was passed for the purpose of making rates, and ever since the Act became effective, fire insurance companies have willingly reported their earnings on their unearned premiums in Missouri, and as a matter of course, Missouri is entitled to credit for these earnings. Even if there was no statute on the subject, inasmuch as insurance companies have only one activity, the writing of insurance, the State would be entitled to credit for their earnings on unearned premiums, but in view of the statute, there can be no question about it.

In 1919, as this record shows, the petitioners asked for a 10 per cent increase in rates. Upon their request being denied, they instituted proceedings in the Circuit Court to compel such allowance. During the trial of that case, their counsel admitted that the State was entitled to consider their interest earnings on their unearned premiums and the matter was never questioned until in this case. This admission is found at pages 296, 297 abstract of the record in that case, Defendants' Exhibit No. 2035. In that case, the attorneys then, for these fire insurance companies, said:

> "Judge Revelle: Right in connection with that part of the request, Mr. Commissioner, we would like to make the statement that in compliance—in response with the Attorney-General's request we are making a showing and producing information as to earnings from all sources, including earnings on capital and surplus and other assets, but that we do not at all concede, but

on the contrary, take the position that only the earnings on unearned premiums are an item that can enter into a consideration of the questions involved in this case, and that the earnings on capital and surplus and other assets are not properly items whose earnings can be considered or material to any of the issues in this case.

Mr. Leahy: And that because of the Rating Act.

Judge Revelle: That is because of the provisions of the Rating Act.

The Commissioner: Yes, we just want the record—

Mr. Leahy: We voluntarily give this information to Your Honor.

The Commissioner: I understand.

Judge Revelle: But do not concede its competency, or that it is an element of consideration to the case.

Mr. Leahy: Our position being under the provisions of the Rating Act that each state is a separate and distinct sovereignty, and the business done in that particular state, irrespective of what is done with the capital and surplus.

Judge Revelle: And only charges us so far as the banking end of the business is concerned with the earnings on unearned premiums."

The position of petitioners' attorneys was right at that time and is right now.

III.

The Missouri Supreme Court rightfully held that $2,496,715 excess commissions gratuitously given insurance agents in St. Louis should be deducted as an operating expense.

These insurance companies admitted that higher commissions were given to St. Louis agents than in

Kansas City or elsewhere. The burden was on such insurance companies to show that this was proper. No explanation at all was given, but it was stated that St. Louis was an "excepted city," and a great many brokers operate there and the agents have to pay the brokers commission for helping them to place the business. The same condition exists in Kansas City and elsewhere, and if the companies desire to pay higher commissions in St. Louis than in Kansas City or elsewhere we concede they may do so, but when it comes to settle with the state as a rate-making body such gratuities must be treated as a corporate expense and not an operating expense. The Supreme Court of Missouri in sustaining the State of Missouri on this point in this case, *Aetna Insurance Company* v. *Hyde*, 285 S. W. l. c. 77 said:

> "In the City of St. Louis commissions were paid to agents much higher than in any other part of the state. These excess commissions amounted during the test period to $2,496,718. The plaintiffs explained that by saying that in larger cities, called excepted cities, such as St. Louis, brokers controlled the placing of a large portion of the insurance written, and they charge the insurance agents a commission for placing the business with them. Thus the people in the rest of the state must pay a higher rate for their insurance in order that the insurance agents in the City of St. Louis may receive a higher commission and pay the brokers a rake-off.
>
> The plaintiff attempts to justify that by saying that it has been in operation for a long time, and it is impracticable to do away with the custom; that the commissions to brokers in St. Louis are not paid by the companies, but paid by the agents out of their own funds. The agents pay it out of their own funds, but they recoup in charging larger

commissions for the risks they write, and thus increase expenses which are charged up as a part of the aggregate expense of operating in Missouri, and therefore must affect the rates.

Mr. George H. Bell, testifying for the plaintiff, said that practically those increased commissions did not affect the rates in Missouri, while theoretically they might. If it is not intended to have any practical effect, it should not be charged. No excuse or justification for so charging it and thus affecting the rates is presented anywhere. People in the State of Missouri should not be required to pay a higher rate for their insurance in order that agents in St. Louis may have an easy time and divide their commissions with brokers. People would insure their property just the same as they do in that city, even if agents did not get their business from the brokers, nor compete with each other for the favors of brokers."

If other authorities are desired to sustain the Missouri Supreme Court on this point we call attention to the opinion of Judge Trieber in the Arkansas rate cases, 187 Fed. Rep. 290. In that case the company rented its hotel, dining room, saloon and lunch stand in its passenger depot at Little Rock for the nominal rental of $1 per annum, although it was worth $4,200 per annum. Although it was held that this company had a right to do this if it desired, still it should be charged with a reasonable value of its property as used by others. Likewise, if the insurance companies desired to gratuitously give brokers commissions in St. Louis, they must be charged with them as a corporate expense instead of an operating expense. See also:

Chicago & Grand Trunk R. R. Co. v. *Wellman*, 143 U. S. 339.

Nebraska v. *Adams Express Co.*, 85 Nebr. 25; 42 L. R. A. (N. S.) 396.

State v. *Virginia & T. R. Co.*, 24 Nev. 53; 49 Pac. 945.

IV.

The Missouri Supreme Court rightfully excluded $628,123 war tax on premiums during the war because said act was repealed after the war and the companies will not have to pay any such tax in the future.

These insurance companies attempted to charge as a part of their operating expense the payment of federal income tax in the sum of $542,933 and the war tax of $628,123, which was in effect only a part of the time during this period and which has since been repealed.

The Missouri Supreme Court found that these companies did not in fact pay the government $542,933 as federal income tax, and since such finding these companies have not mentioned the question in this court. Simply as an illustration as to how these insurance companies attempted to pad their expense accounts against the state of Missouri, we ask the court to read that part of the Missouri opinion refusing to allow this amount, because not paid.

They claim, however, that during a part of this period as a war measure Congress required them to pay a war tax on Missouri premiums and that during this period they actually paid $628,123. Although the act has long since been repealed and they will not have to pay it in the future, they want credit for the payment of this sum. The five-year test period provided for in the Missouri Rating Act is for the purpose of considering the experience with a view of fixing proper rates for the future. All rates, of course, are made for the future and it appearing that the companies will not have to pay this sum in the future, the Missouri Supreme Court rightfully held that they were not entitled

to any credit for such payment, and in *Aetna Insurance Company* v. *Hyde*, 285 S. W. l. c. 77, said:

> "Another tax amounting to $628,123 was a war tax paid on Missouri premiums. The law imposing that tax was no longer in operation at the time the reduction order was made, but in paragraph IV we have sufficiently explained why that should not be charged. Plaintiffs present no reason why that tax, which would not be imposed from the time the order was made, should be listed as an expense in fixing future rates."

The Missouri Supreme Court did not in fact disallow this charge of $628,123, but simply stated it would not be charged against the companies in the future and should not be considered in the future fixing of rates. That this is correct is unquestionable. It will be well to remember also that the court held that a trifle more than $6,000,000 was a profit of 8 per cent, while the companies earned more than $8,000,000 and with this deduction in question more than $9,000,000, or as the court says, about 40 per cent more than a reasonable profit. The Missouri Supreme Court was undertaking to allow these companies an 8 per cent return because that is what they said they were entitled to. Without really passing on the question as to whether an 8 per cent return was too much, the court simply, for the purpose of this case, agreed that it was proper. As a matter of fact this court has repeatedly held that a 6 per cent return is sufficient and we do not believe any court has ever set aside a reduction where a 6 per cent return was provided. So that we have a margin of nearly $3,000,000 above an 8 per cent return and of course much more above a 6 per cent or 7 per cent return.

V.

The Missouri Supreme Court did not of itself fix 8 per cent of premiums received as a reasonable profit upon the business of the companies, but merely for the purpose of argument accepted such figure because requested so to do by the insurance companies. They have always insisted that they were entitled to a profit of 8 per cent and the state never questioned it because the profit actually received by them is so much more.

It is difficult to understand what these insurance companies mean by the statement under this point. They seem to complain of the statement of the Missouri Supreme Court that they are entitled to a profit of 8 per cent. The court did not actually so find, but accepted the statement that that was the profit they were entitled to. Throughout this record they have repeatedly insisted they were entitled to 8 per cent profit upon the volume of business. The state has never agreed to this, but inasmuch as their profit has been so much more, it is really a moot question.

The Missouri Supreme Court actually found that during this five-year test period in Missouri these insurance companies made a profit of $9,310,087, or about 40 per cent more than was conceded to be a reasonable profit, and in so stating in *Aetna Insurance Company* v. *Hyde*, 285 S. W. l. c. 78, said:

> "As stated above, a reasonable profit is 5 per cent on the business done, premiums received, and 3 per cent additional for conflagration hazard, or 8 per cent, which would be $6,680,169 for the test period. Therefore, $8,681,964 was an unreasonable profit, and justified a reduction under the circumstances shown. With the war tax eliminated, it would have been $9,310,087, about 40 per cent more than what was conceded to be a reasonable profit."

Counsel for petitioners before this court pretend to misunderstand the actual profit made by these companies as declared by the Missouri Supreme Court, but on any possible theory this court will have no difficulty in coming to the conclusion that these companies made an enormous profit in Missouri during this period, and this 10 per cent reduction will have to be sustained.

This period was 1917, 1918, 1919, 1920 and 1921. At the beginning of 1920 these companies were granted an increase of 15 per cent and the present reduction order now questioned and before this court was to become effective in October, 1922, reducing the then existing rates 10 per cent, which would allow the companies to still receive 5 per cent of the 15 per cent increase granted them in January, 1920. In other words, this reduction of 10 per cent in October, 1922, was levelled against the 15 per cent increase granted these com-

panies in January, 1920, and did not affect the rates at all on which they earned this enormous profit, and in the future years they will still receive 5 per cent more than they received during this period.

But these insurance companies say that under Section 6222, Revised Statutes of Missouri, 1919, they are compelled by law to set aside as a reserve 50 per cent of the gross premiums, and that no consideration should be given to this sum so set aside because in effect it is not their money.

This section has nothing in the world to do with rate-making, but simply requires these fire insurance companies to maintain this reserve to safely reinsure their risks in case they become insolvent, go out of business, or desire to sell their business. Such section is not a part of the Missouri Rating Act and has nothing to do with rate making. This reserve for the purpose of reinsuring can be carried just as well by using the method of premiums received as premiums earned. In fact the reserve could be more successfully maintained by using the method of premiums received, as contended by the state, because there would be more money available to make up this reserve. The companies in this case during this period took in more than $87,000,000 and a much greater reserve can be set up from this sum than the sum of $74,000,000, which they say they should be charged with. It stands admitted by this record that a reserve can be maintained as well under the state's theory as under the companies' theory (R. 2750-2751).

As a bookkeeping entry these companies set aside this sum of money as a reserve, but all of the time they

have charge of it and are using it in their business the same as all of their other money. It is not in any sense a separate fund, but belongs to them the same as their other money belongs to them and they loan it out and receive a rate of interest upon it.

That part of Section 6222, *supra*, which they now for the first time claim requires them to set aside as a sacred fund 50 per cent of their premiums, reads as follows:

> "Fifth: Premium reserved or amount required to safely reinsure all outstanding risks to be estimated by taking fifty per cent of the gross premiums on all unexpired fire risks that have less than one year to run and a *pro rata* of all gross premiums on risks that have more than one year to run."

Such section does not deal with rate-making at all and the uncontradicted testimony in this record is that they never attempted to set aside in a separate fund any sum of money, but that all of their money went into what was commonly called a "jack pot" and all of it for all purposes was paid out of such "jack pot" (R. 814-815-890-1192-1193-1202).

There is no merit to this position now taken, as will clearly appear to this court from a reading of the record. They said all the way through this trial that they were entitled to a profit of 5 per cent and a 3 per cent allowance for conflagration liability (R. 771).

However, they wanted this profit according to their peculiar way of figuring profit, which means on the basis of premiums earned, losses and expenses incurred.

as distinguished from premiums received, losses and expenses paid. The state has no particular objection to an 8% return, as they earned much more than this upon a reasonable and proper method. However, this court should understand that a 5 per cent underwriting profit on the method used by these companies would make a return of at least 500 per cent to their stockholders (R. 895).

Mr. Arthur S. Baty, the man employed by these companies to prepare figures in this law-suit, testified that for ten to twenty years prior to this period and on the basis now contended for by these companies for the first time, such companies generally did not earn as much as 1 per cent underwriting profit (R. 1956).

Mr. Walter K. Chorn, formerly with the insurance department, testified that during such time such companies made an underwriting profit, on their peculiar and unfair method of figuring, of less than one-half of 1 per cent (R. 2844-2877-2878).

These companies now desire to be allowed a 5 per cent underwriting profit, using the same unfair method, which would give them an outrageous profit, and as Mr. Chorn says would result in state insurance, as the people would never stand for such enormous earnings (R. 2877-2878).

Mr. Wilfred Kurth, vice president and secretary of the Home Insurance Company, testified that he thought these companies should be allowed a 10 per cent underwriting profit, using the peculiar and unfair method which they have adopted, but that during this period they paid their stockholders 25 per cent in cash dividends and added to their surplus for their benefit 90 per cent, and that if allowed to earn a 10 per cent

underwriting profit, using the peculiar and unfair method which they have adopted, his companies could have returned to their stockholders during this period 600 per cent (R. 895).

Obviously, therefore, these insurance companies have no complaint against that part of the opinion of the Missouri Supreme Court suggesting that 8 per cent is a reasonable profit for them. In fact they are not interested in such statement, because they got much more than 8 per cent.

Fire insurance companies do not set up and maintain a reserve.

The testimony in this case demonstrates conclusively that fire insurance companies do not set aside, earmark and maintain a reserve of any kind. The money originally comes from policyholders and thereupon is loaned out. All of the money is placed together and payments made out of the general fund. The insurance companies claim they maintain a conflagration reserve of 3 per cent. The testimony shows, however, that they do not set aside any such sum and keep the same separate, but place all of their money together. They also claim they maintain a premium reserve, but they do not set aside such reserve and keep it separate and apart from their other funds. They claim they maintain other reserves, but what they really mean is that purely as a bookkeeping entry and fiction they attempt to show by their books what money belongs to certain funds. However, their money is all placed together and from the total sum all expenses and liabilities of all kinds are paid. Dividends are paid out of

the same fund. Losses are paid out of the same fund. Salaries and other expenses are paid out of the same fund. The testimony shows that all of the money is placed together and all of their expenses are paid out of the same fund indiscriminately (R. 814-815-890-892-1192-1193-1202).

Perhaps the best statement of the matter as showing that their statement under this point regarding the maintenance of a reserve is pure fiction is made by the Missouri Supreme Court in the case of *Aetna Insurance Company* v. *Hyde*, 285 S. W. l. c. 80, wherein it is said:

> "Section 6222, R. S. 1919, in insurance parlance 'a reserve' is maintained to cover unearned premium liability. But such 'a reserve' is purely a bookkeeping fiction. The rates are not loaded for the purpose of creating such a separate fund. None in fact exists. The phrase 'unearned premium reserve' merely designates the amount of the contingent liability to which all the assets of a company are subject. Of course if those assets are not sufficient both to discharge incurred liabilities and to cover the contingent liability a proper 'reserve' is not being maintained."

It will not do, therefore, to say that these companies set aside and maintain either a premium reserve or a conflagration reserve. All of their money is kept together. Losses are paid out of the current receipts and the unearned premium reserve is not maintained so that anything can be paid out of it, and nothing is paid out of it. Petitioners in some instances call this reserve an asset because it belongs to them, and in other instances they call it a liability because they say it does not belong to them. In speaking of this reserve,

which does not exist, at page 170 of their brief filed before the Missouri Supreme Court they said:

> "The unearned premium, in so far as it can be said to be any fund, is part of the general assets *and not any insurance reserve in an appropriate sense.*"

Having lost on that theory in the Missouri Supreme Court, they now say that the unearned premiums are a reserve and required by law to be maintained by them, although of course such is not the case, as this court will ascertain.

This court will observe that petitioners were required by law to file sworn reports with the Missouri Insurance Department each year and they did so. However, at the trial, after the state had shown that these sworn reports so filed, on which the the superintendent was required to act, were false and erroneous, they attempted to say they did not understand the reports, although their actuaries are the most skilled in America and the reports were very simple. Finally these insurance companies themselves admitted in open court that their sworn reports filed with the department were inaccurate, unfair, contained many duplications and were indefensible (R. 535 299-522).

Such reports, as we have stated elsewhere, charge the state with more than $500,000 federal income tax which they claimed they had paid to the Federal Government, but the Missouri Supreme Court found they had not paid a dollar to the Government on their Missouri business because they had reported to the Government a loss. It is sufficient to say that they

are not now questioning this finding of the Missouri Supreme Court, but in effect admit that they attempted to charge Missouri with more than $500,000 which they had previously sworn they had paid and which they now in effect admit they never paid.

Petitioners contended that they were entitled to an 8 per cent profit on their volume of business. The state never really questioned this because they had earned so much more than 8 per cent on their volume of business. However, the state contended throughout the trial that it was unfair to allow the fire insurance companies a profit upon their volume of business. It was the state's theory that their capital and surplus should be apportioned to Missouri in proportion to the business produced by Missouri as compared with the United States. Expenses were apportioned to Missouri on this basis and the state took the position that if it was fair for these insurance companies to apportion their expenses throughout the United States to Missouri on the basis of Missouri business as compared with the business of the United States, then the capital and surplus should be apportioned to Missouri on the same basis and a return allowed upon that. The testimony shows that the capital apportioned to Missouri on this basis was more than $17,000,000 and that both capital and surplus apportioned to Missouri was in excess of $54,000,000. Instead therefore, of allowing petitioners an 8 per cent return upon $83,000,000, they should have been allowed a return upon $54,000,000. They actually earned on their entire volume of business, as contended for by them, nearly $3,000,000 more than an 8 per cent return, but if only allowed a return

upon their apportioned capital and surplus of $54,000,000 obviously they earned more than 15 per cent in Missouri during this period. Tables were submitted and are in this record showing the state's theory on this point, and in view of the fact that the Kansas Supreme Court has recently adopted this method of figuring profit and loss, we invite a serious consideration of it.

VI.

The Rating Act of Missouri is constitutional and this court has repeatedly held that fire insurance is impressed with a public trust and is a proper subject of regulation.

These fire insurance companies now attempt to say that the Missouri Rating Act, as interpreted by the Supreme Court of Missouri, is unconstitutional. They stipulated and agreed in writing that the question of the constitutionality of such act should not be raised. However, if they feel now that such act is unconstitutional, it will not be difficult for this court to see that such position is unsound. This court, speaking through Mr. Chief Justice Taft in *Insurance Company v. Wandberg*, 260 U. S. l. c. 73; 43 Supreme Court Reporter 32, said:

> "The decision of this court in *German Alliance Insurance Company* v. *Lewis*, 233 U. S. 389, settled the right of a state legislature to regulate the conduct by corporations, domestic and foreign, of insurance *as a business affected with a public interest.*"

In the case of *Company* v. *Lewis*, 233 U. S. 389; L. R. A. 1915, 1189, referred to by Chief Justice Taft, it is said:

> "A *business* may be so far affected with a public interest as to permit legislative regulation of its rates and charges, although no public trust is imposed upon property, and although the public may not have a legal right to demand and receive service. *The business of fire insurance is so far affected with a public interest as to justify legislative regulation of its rates.*"

If further authority is desired on this point we call attention to:

State ex rel. v. *Harty*, 278 Mo. l. c. 691.
Co. v. *Welch*, 49 Okla. 620; 154 Pac. 48.
Henderson v. *McWaters*, 104 S. C. 268.
Co. v. *Barnes*, 189 Fed. 769.
Martin v. *Howard*, 96 Nebr. 278; 147 N. W. 689.
Co. v. *R. R.*, 77 N. H. 6; 45 L. R. A. (N. S.) 845.
People v. *Co.*, 126 Ill. App. 636.
12 Corpus Juris, 850.

No Federal question was involved in the decision of the Missouri Supreme Court. Such court simply construed a Missouri statute and no Federal question was decided against these insurance companies. The construction placed upon the Missouri statute by the Missouri Supreme Court should be adopted by this court.

Petitioners repeatedly say throughout their brief that they have two activities: (a) underwriting, which means the writing of insurance and the collection of premiums; (b) banking, which means the loaning of the money which they secure from the policyholders. They insist they are entitled to an underwriting return

and a banking return. In reality they have only one activity and that is the writing of insurance. All other matters are purely incidental. On October 8th, 1927, the Supreme Court of Kansas in a rate case between the State of Kansas and petitioners the *Aetna Insurance Company, et al., Appellees*, v. *Frank L. Travis, Superintendent of Insurance of the State of Kansas, Appellant* (not yet reported), in discussing this point aptly said:

> "Plaintiffs call our attention to the *Minnesota Rate Cases*, 230 U. S. 352, and allied cases, which hold, in substance, that assets and property of a public utility not devoted to public service cannot be considered as a basis of rate-making. The rule is sound in reasoning and is sustained by an array of authority. The difficulty of applying the doctrine of these cases of stock fire insurance companies, and especially to the case before us, is that there is no showing that the capital or surplus of plaintiffs, or any part of it, is not used in the insurance business. In fact, the testimony from each of the officers of plaintiffs who testified upon the subject is that capital had been increased from time to time and the surplus had been in part, retained and not disbursed to the stockholders because it was advantageous to plaintiffs in the insurance business. It is argued that separate employees, and in some instances separate officers of the company, devote their time to investment, while others give attention to the underwriting. This is not a reason for regarding the businesses as separate. In any large business no one person can transact all of it. The fact that some employees or officers devote their time to a particular part of the business rather than to another is no indication that all of it is not a part of the insurance business as a whole. Plaintiffs speak of the investment portion of their business as a banking business, or the

banking end of their business. In a series of decisions, years ago, the distinction between the insurance business and the banking business was noted, and it was held the one did not embrace the other. (*New York Fire Ins. Co.* v. *Ely*, 5 Conn. 560; *The Aetna Nat. Bank* v. *Charter Oak Life Ins. Co.*, 50 Conn. 167, 183; *Blair* v. *Perpetual Insurance Company*, 10 Mo. 559; *Ohio L. I. & T. Co.* v. *Merchants', etc., Co.*, 11 Humphrey, 1 (Tenn.); *Life Association of America* v. *Levy*, 33 La. Ann. 1203; *Hunter* v. *Union Trust Co.*, 51 N. E. 1071 (Ind.); *Myers* v. *Mutual Life Ins. Co.*, 153 Ind. 204; *Robotham* v. *Prudential Insurance Co.*, 64 N. J. Eq. 673; *National Bank of Washington* v. *Insurance Co.*, 41 Oh. St. 1.)

In *Memphis* v. *Memphis City Bank*, 91 Tenn. 574, the court held that a corporation entitled the 'Memphis City Fire and General Insurance Company,' whose officers are authorized to write insurance of various kinds, 'and generally to do all things necessary and proper in carrying on the general insurance business,' is not empowered to do a banking business, although its charter provides that it may purchase, hold, and convey any and all kinds of estate, real, personal, or mixed, receive in trust money or other valuable things, and loan surplus funds on any stocks of any incorporated company, or of the United States, or 'invest them in any real or personal estate, or choses in action, or other good securities.'

And, on appeal of that case to the United States Supreme Court, 161 U. S. 186, touching the claim of the company that it had, by legislative authority, changed its business from an insurance business to a banking business, and was then entitled to certain exemption from taxation which it enjoyed while conducting an insurance business, the court said: 'We think the change from the business of insurance to that of banking is a material and radical change,' and denied the contention.

> Plaintiffs are not incorporated as, and do not have the functions of, banks. They are insurance companies, required by law to have a capital and surplus with which to conduct their business; and all of their business transactions, their underwriting and their investments, are supervised and regulated for the common good, because the business as a whole is one clothed with the public interest. (*German Alliance Ins. Co.* v. *Kansas, supra.*)"

VII.

Petitioners erroneously assume that if a single attack made by them is sustained, the opinion of the Missouri Supreme Court must fall. Such a statement is not in any sense accurate.

The Missouri Supreme Court in its opinion, *Aetna Insurance Company* v. *Hyde*, 285 S. W. l. c. 78, in speaking of the profit made by these insurance companies in Missouri during this five-year period, says:

> "As stated above, a reasonable profit is 5 per cent on the business done, premiums received, and 3 per cent additional for conflagration hazard, or 8 per cent, which would be $6,680,169 for the test period. Therefore, $8,681,964 was an unreasonable profit, and justified a reduction under the circumstances shown. With the war tax eliminated, it would have been $9,310,087, about 40 per cent more than what was conceded to be a reasonable profit."

Counsel for these insurance companies state that the Supreme Court of Missouri found that they made in excess of a reasonable profit only $607,040. Such is not the holding of the Missouri Supreme Court.

As stated before, in January, 1920, these companies were given a flat increase of 15 per cent by Missouri. In October, 1922, this 10 per cent reduction was or-

dered. It was a reduction against the then existing rates, which had been increased 15 per cent in 1920. In other words, after such 10 per cent reduction became effective the companies still had the advantage of a 5 per cent increase over that granted them in 1920. The profit of these insurance companies in Missouri during this period was enormous and sufficient to stand a 10 per cent reduction and still allow them to make in the future more than a reasonable profit.

The Supreme Court of Missouri did not find at any time that petitioners had made only $607,040 more than an 8 per cent profit. Petitioners insisted they were entitled to an 8 per cent profit, although, as this court knows, 6 per cent is the ordinary and usual profit allowed a utility, and in some instances 7 per cent. The Supreme Court simply said that if these petitioners desired an 8 per cent return, it was obvious that they had made much more than that, so the question is really a moot one. The court found that to allow them an 8 per cent return would mean a profit of $6,680,169. They in fact, after the deduction of 10 per cent in question, they actually made $8,681,964, or instead of $607,040 more than a reasonable profit, more than $2,000,000 over a reasonable profit. Also eliminating the war premium taxes, which they paid during the war and which they will not have to pay in the future, their profit would be in excess of an 8 per cent return, $9,310,087, or as the court puts it "about 40 per cent more than what was conceded to be a reasonable profit."

It is interesting to observe that the Missouri Supreme Court carefully analyzed the earnings of these

petitioners and reached the conclusion that they were trying to load their underwriting experience because rates are based upon such experience, and in so doing their purpose was to always show a loss in their underwriting business, and when confronted with the enormous profits, they say that such profits resulted, not from the underwriting business, but from the investment or banking business. In showing that this could not be true, according to this record, the Missouri Supreme Court in this case between the same parties, the *Aetna Insurance Company, et al.*, v. *Hyde*, 285 S. W. l. c. 69, said:

> "The evidence showed that the companies made enormous profits during the period under investigation and paid large dividends. We cannot avoid noting that the government, state, and municipal bonds and other safe securities which the law requires insurance companies doing business in the state to invest their capital in bear low rates of interest. They are the safest, though the least remunerative, methods of investment. Yet the plaintiffs insist that, notwithstanding the large aggregate profits of the companies, their underwriting business results in a serious loss, and these profits occur notwithstanding such loss. They claim that the large profits are due to the investment branch of the business. We are not inclined to think that the conclusion thus reached is a triumph of bookkeeping skill rather than a scientific elucidation of the actual facts.
>
> Of course, we are not concerned about how much profit the plaintiffs make on their investments, but the figures given below are important in determining their underwriting profits. A large number of exhibits with a great mass of figures are in evidence. A few of these may assist in understanding the discussion of the items to follow.

The capital apportioned to Missouri during the 5-year period was $17,816,887, and the surplus was $36,842,320, a total of $54,659,207. The investment profit on this was $1,914,940, as stated. These figures show the added capital and surplus for the 5 years, and the profit for that time. To obtain the average sum in actual use and the returns on it, this total must be divided by five. The total profit is the same as would be realized on the total investment for the year. It figures about 3½ per cent per annum. We are not to suppose that the companies made a larger profit on their general investment business. The above sums were apportioned to Missouri, on the state's percentage of the general business, investments, and profits in the same proportion. Some of the exhibits show the character of their investments, stocks, bonds, real estate, loans and the like. None of them indicate speculative risks on which large returns might be expected to account for large profits. So far as Missouri is concerned, the plaintiffs show a great loss for 5 years, taking into consideration all their business, investment and underwriting. We are not pointed to any evidence where this loss was made up in other states by higher insurance rates than were paid here. There was evidence of enormous conflagration losses prior to the test period, 1917-1921. How can we account for the extraordinary profits?

Taking all the business everywhere of all the companies for the 5 years, we have:

Total capital	$ 615,630,115
Total contributed surplus	14,155,423
Capital and contributed surplus	629,685,538
Total earned surplus	1,258,329,906
Grand total	$1,888,015,444

Thus it will be seen that the contributed surplus, the surplus paid in by the stockholders, was insignificant, while the earned surplus was more than double all sums paid in by stockholders, both capital and contributed surplus. So the insurance companies must have been quite prosperous before the test period began, notwithstanding conflagration losses. At the low rate of investment earnings, it would take a long time for the money paid in to increase that much. We have not consulted interest tables, but, no doubt taking account of periods when funds must be idle, 30 or 40 years must elapse before a sum invested at 3½ per cent, compounded, can triple itself, even if no dividends were paid from the increase. It is incredible that the large profits could come from investments. The above figures are cumulative. To get the average for 5 years they must be divided by 5.

The capital and contributed surplus in 1917 was $109,813,161, and in 1921 it was $149,003,201, while the average for the 5 years was $125,937,104.

In 1921 the earned surplus was	$293,845,008
In 1917 it was	197,903,541
Gain in five years	$ 95,941,467

Thus, while the large earned surplus showed prosperity before 1917, it showed equal prosperity during the 5-year period by adding $95,941,467 to the investment funds. During the 5 years the companies paid $110,142,849 in dividends. Thus the gain was:

Earned surplus	$ 95,941,467
Dividends	110,142,849
Total	$206,084,316

Divide that sum by 5, and we have $41,216,863, the average annual net profit.

The total capital and contributed surplus during the period was $629,685,538, with an annual average of $125,937,107. So the profit was nearly 30 per cent on that. Add the earned surplus, and the whole investment sum available during the period was $1,888,015,444. Divided by 5, $377,603,088, the average for the 5 years. The average increase of $41,216,863 was approximately 11 per cent per annum. This accounts for the ability of the companies to pay large dividends on the money actually invested, and at the same time annually lay up a surplus to augment their investment funds.

The total capital and surplus in 1921 was $442,848,209; in 1917, $307,716,702, an increase of $135,131,507. Of this about $40,000,000, as noted above, was increased capital, probably due to the formation of new companies, whose capital did not earn much at first. The greater part of the new capital was added in the last 2 years. So that the total earnings appearing in dividends and earned surplus $206,084,316, as shown above, was almost wholly from the $307,716,705 on hand in 1917, approximately 67 per cent, or about 12½ per cent per annum.

While a large part of this profit must have come from the underwriting side of the business, it does not tell the whole story, and does not account for all the profits. We find it difficult to reconcile that moderately large profit with the following figures: The total underwriting profit of all the companies during the 5 years was $409,944,558. The investment profit was $138,253,522. Total, $548,198,080.

As shown above, the cumulative capital and surplus for the 5 years was $1,888,015,444, an average of $377,603,089 a year, of which the contributed capital and surplus averaged $125,937,107. Thus the earnings for the 5 years was nearly four and a half times the money originally invested by the stockholders, and nearly one and a half times,

or 150 per cent of the capital, paid surplus and earned surplus combined. This is more than 80 per cent per annum on the original investment, and 29.03 per cent per annum on the investment accumulated earned surplus. On this 29.03 per cent, 7.32 per cent was due to investment earnings, and 21.71 per cent was due to underwriting earnings, as shown by the tabulations in the exhibits. Thus about three-fourths of all the earnings of the plaintiffs were underwriting earnings.

Was any business ever so generally prosperous? The plaintiffs, by this showing, every 5 years can quadruple their original investment, or double their total accumulations, and at the same time pay as dividends 10 per cent per annum. Three-fourths of this is due to the underwriting business, as they count it, notwithstanding the enormous losses in that branch of the business in Missouri. Yet, as we will show, more than half of the stated investment earnings are directly due to the underwriting business. Are we to believe that rates are so much higher in other states than here, notwithstanding many of them have rating acts, that this enormous profit can thus be accounted for? The evidence does not show any such condition. On the contrary, by the method of ascertaining profits and losses, which the respondents seek to apply to this case, the companies during the last 20 years have made an underwriting profit of less than one per cent. This in the teeth of the undisputed figures that the underwriting profit has resulted in the enormous gains shown above. Thus the, to us, unexplored mysteries of bookkeeping present the problems to be solved.

It may be noted that the income on the capital and surplus is 7.32 per cent per annum, about double the $3\frac{1}{2}$ per cent profit on those items in Missouri. In fact, the total invested funds is more than double the capital and surplus to invest. The bonds, stocks, loans, etc., for the period

were $4,156,861,763, while the total capital and surplus was $1,888,015,444, or a little over 45 per cent of the total. We account for that in this way: There is always on hand a large sum in unearned premiums. It averages more than all the capital and surplus combined, and is invested in the same safe way that the capital is invested. The companies keep invested, bearing interest all the time, five or six times as much money as their stockholders ever paid in as capital and surplus. This is illustrated in that part allocated to Missouri, as shown in defendant's claim above:

Interest on unearned premium	$2,301,132
Interest on capital and surplus	1,914,940
Total investment earnings	$4,216,072

Thus the unearned premiums amount to more and earn more profit than all the invested capital and surplus. In truth, they occupy so large a space in the argument, and are so important in determining what are underwriting profits, that we must next consider the respective claims in regard to them."

Obviously, petitioners were trying to impose upon the state and we ask them to answer the question in this court, as asked by the Missouri Supreme Court:

"Was any business ever so generally prosperous? The plaintiffs, by this showing, every 5 years can quadruple their original investment, or double their total accumulations, and at the same time pay as dividends 10 per cent per annum."

VIII.

The decision of the Missouri Supreme Court construes the Missouri Rating Act and this court will follow the construction placed upon such act by the highest court of the state. Such construction does not to any extent deprive petitioners of property without due process of law.

The Missouri Supreme Court was simply called upon to construe Missouri Statutes. The Missouri Rating Act is a complete act within itself and the words "earned premiums" cannot be found in same. Section 6280, Revised Statutes of Missouri, 1919, requires the insurance companies to file with the Insurance Department a report showing "the net amount of insurance in force and written, net premiums received and net losses paid." Section 6281 following requires all fire insurance companies doing business in Missouri to report to the insurance department "the total amount of its premiums, losses and expenses."

In view of this plain language the Missouri Supreme Court found that the proper basis for rate-making was premiums received, losses paid and expenses paid. Inasmuch as the statute itself requires that consideration be given only to premiums received and losses and expenses paid, obviously the Supreme Court of Missouri could not have held otherwise. The statutes cannot be construed any other way.

Two theories were presented to the Supreme Court of Missouri as to the meaning of the Missouri Statutes. The supreme court, in a very learned opinion, adopted the construction as contended for by the state. Naturally the insurance companies complained of the con-

struction placed upon such statutes, but the rule is universal throughout America that the construction of a statute by the highest court of the state will be followed by this court, unless of course such construction deprives the other side of a constitutional or a federal right. No federal question was mentioned or discussed by the Missouri Supreme Court. It was not necessary to consider a federal question and none was considered. Simply because the supreme court did not agree with these insurance companies is no reason for this court to assume jurisdiction in a matter involving a plain construction of a Missouri statute.

In holding that it was the duty of the Missouri Supreme Court to construe the Missouri Rating Act and that the construction placed on same would be adopted by this court, Mr. Justice Sutherland in the case of *Supreme Lodge, Knights of Pythias* v. *Meyer*, 265 U. S. l. c. 32, said:

> "Under the settled rule of this court, declared so frequently and uniformly as to have become axiomatic, we must accept this decision of the highest court of the state fixing the meaning of the state legislation, as though such meaning had been specifically expressed therein. See, for example, *Leffingwell* v. *Warren*, 2 Black, 599, 603; *Green* v. *Lessee of Neal*, 6 Pet. 291, 297-300. And we follow the state construction even though it may not agree with our own opinion. *Supervisors* v. *United States*, 18 Wall., 71, 82; *Shelby* v. *Guy*, 11 Wheat. 361, 367; *Tioga R. R.* v. *Blossburg & Corning R. R.*, 20 Wall. 137, 143."

In the Missouri Supreme Court the fire insurance companies contended that under the Missouri Rating Act profit or loss could be determined only upon the

basis of premiums earned, losses and expenses incurred. The state contended that under such act the proper method was premiums received, losses and expenses paid. It was purely a matter of construction of the Missouri Rating Act and in holding that this was a matter for the state court to determine, Mr. Justice Van Devanter in *Des Moines National Bank* v. *Fairweather, et al.*, 263 U. S. l. c. 105, said:

> "We are asked to go into the proper construction of the state statute and its validity under the state constitution. But these are questions of local law, the decision of which the supreme court of the state is controlling. *First National Bank of Garnett* v. *Ayers*, 160 U. S. 660, 664; *Merchants' and Manufacturers' National Bank* v. *Pennsylvania*, 167 U. S. 461; *Lindsley* v. *Natural Carbonic Gas Co.*, 220 U. S. 61, 73; *Price* v. *Illinois*, 238 U. S. 446, 451."

The evidence in this case shows that the premium earned theory contended for by these fire insurance companies is fundamentally unsound and erroneous in that it excludes from consideration large portions of income and includes all of the expense which will ever attach to the acquisition of such income, amounting to 42 per cent of same and considering, in the matter of incurred losses, a large amount of apparent losses which will never be paid, as for example, recoverable reinsurance, salvage, defeated claims, settled claims, and over-estimates of the actual loss, because incurred losses in themselves are based upon a mere arbitrary calculation of what the loss will actually be and because all losses are paid out of current receipts, no matter when same may have happened; because, fur-

ther, it is a matter of calculation so fundamentally unsound and economically erroneous that it reflects a complete false result, in that if business is on an ascending scale and is prospering, by this curious method of calculation, there will apparently be no profits; if the business is declining, by this method of calculation, there will apparently be large profits. By this method, when the companies desire to calculate the earned premiums, and take over the premiums received during the five year period under investigation, they add to that all of the outstanding unearned premiums at the beginning of the period and subtract all of the outstanding unearned premiums at the end of the period, that is, on an ascending scale of business they add the smaller amount and subtract the larger amount.

In the instant case they added at the beginning of the period $9,000,000.00 (R. 2029, 2254, 2258) and subtracted at the end of the period more than $17,000,000.00 (R. 2029, 2255, 2258), leaving a difference of more than $8,000,000.00, which they did not consider as income at all, but 42 per cent of that income representing expenses was considered as part of the experience of the five years in arriving at the result of that experience. Curiously enough in arriving at incurred losses and expenses, the companies simply reversed the method and, instead of adding the outstanding incurred losses and expenses at the beginning of the period, they subtracted them, but added the outstanding incurred losses and expenses at the end of the period; so that on an ascending scale of business, a majority amount of expenses and losses are added at the end of the period, but are subtracted at the begin-

ning of the period. So that, in arriving at a rate by the use of this method, the companies resolve every advantage in their own behalf. The unanimous opinion of the Supreme Court of Missouri was that this method of calculation was fundamentally unsound and erroneous and that it was evidently the invention of ingenious insurance counsel or even more ingenious insurance accountants; that the insurance companies always construed the Missouri Rating Act as now contended for by the state, and on such construction secured at least two increases, and naturally the Supreme Court of Missouri construed the Rating Act to mean premiums received as distinguished from premiums earned, and that this court would not interfere with the construction placed upon this Missouri Statute by the highest court of the state is aptly said by Mr. Justice Peckham in quoting from Mr. Justice Harlan's opinion in *Lent* v. *Tillson*, 140 U. S. 316, in the case of *Hibben* v. *Smith*, 191 U. S. l. c. 325:

> "In *Lent* v. *Tillson*, 140 U. S. 316, which was an assessment case, it was stated by Mr. Justice Harlan, in delivering the opinion of the court (p. 333), as follows:
>
> 'Other objections have been urged by the plaintiffs which we do not deem it necessary to consider. For instance, it is said that the mayor of the City of San Francisco, one of the board of commissioners, was himself the owner of a lot on Dupont Street, and, for that reason, was incompetent to act as one of the board of street commissioners • • • In respect to all these and like objections, it is sufficient to say that they do not necessarily involve any question of a federal nature, and so far as this court is concerned, are concluded by the decision of the Supreme Court of California.'"

The Missouri Rating Act requires the superintendent of insurance, upon complaint, to investigate the necessity for a reduction of fire insurance rates. A stipulation was entered into between the state and petitioners that the hearing should be held at a certain time and there was no objection presented to such hearing.

The stipulation provided:

> "That in such matter the question of the constitutionality of Section 6283 and 6284, Revised Statutes of Missouri, 1919, shall not be raised, nor shall the legality of the hearing provided for be questioned" (R. 26).

The Insurance Commissioner ordered a 10 per cent reduction of fire insurance rates and petitioners, insisting that he did not follow the Missouri statutes, filed a suit for review. The Supreme Court of Missouri sustained the Insurance Department. The opinion holds that the Insurance Department properly followed the Missouri statutes. If any conflict with the Federal Constitution appears, which we deny, it necessarily arises over the actions of the Insurance Commissioner in following the Missouri Statute, which the Supreme Court says he was authorized to do. Obviously, therefor, this assault is upon the constitutionality of the Missouri statute, because it was followed by the Insurance Commissioner and the Supreme Court of the State said he was authorized to follow it. He did not decide any question adversely to the statute, but followed the statute.

Petitioners insisted before the Supreme Court of Missouri that the statute meant one thing, and the

state insisted that it meant another thing. The supreme court approved the action of the Insurance Commissioner under such statute, necessarily adopting the state's method of figuring profit and loss. It is now asserted that by adopting such method, petitioners are deprived of their property without due process, under the Fourteenth Amendment, yet it appears that on the method adopted by the Insurance Commissioner and approved by the supreme court, petitioners earned two million dollars more than an 8 per cent return, and eliminating the war tax, which will not have to be paid in the future, about three million dollars more than an 8 per cent return. How, then, can petitioners now insist that the method used by the insurance department and adopted by the supreme court confiscates their property? It leaves them, as the supreme court says, about 40 per cent more than an 8 per cent return.

Petitioners now say that they are not attacking the constitutionality of the Missouri Statute but only attacking it as construed by the insurance department and by the supreme court of the state. What they mean is that had the supreme court construed it in the way they wanted it construed, they would not have attacked it. Having construed it the way the state desires it to be construed, they say they have a perfect right to attack it. If, so, what was the use of wasting time and entering into the stipulation. They solemnly said, "The question of constitutionality • • • shall not be raised."

Now they say they meant it should not be raised if decided in their favor but if decided against them

they could raise it. The stipulation does not mean this and only desperation causes counsel for petitioners to take such a view. The stipulation means exactly what it says, and petitioners should not be allowed to violate it in this court.

IX.

No federal question is in any way involved in this case. The decision rests on independent grounds not involving a federal question, and although federal rights were asserted by these insurance companies, no consideration of a federal question of any kind was considered. It was not necessary to consider such a question and it was not considered.

No federal question is involved in this case. These fire insurance companies were operating in Missouri under a license from the State Insurance Department. They were authorized to conduct a fire insurance business in the state. They had no property in the state, but simply exchanged contracts of insurance for money. It is true they alleged in their petition for review that the reduction order of 10 per cent would compel them to do business in Missouri at a loss, but no question of confiscation is involved because they have no property in Missouri, and made an enormous return. The Fourteenth Amendment is not in any sense involved in this case. The mere allegation that the reduction order would compel them to do business at a loss is not sufficient to invoke the protection of this section. The evidence overwhelmingly shows that they were earning an enormous profit in Missouri and that they would continue to earn enormous profit with the 10 per cent

reduction in effect. Suppose a carrier alleges a reduction order if enforced would be confiscatory and thus seeks the protection of the Fourteenth Amendment. Suppose upon the trial the evidence shows with the reduction in effect the carrier would earn an enormous profit. Under such circumstances is the Fourteenth Amendment involved. Such amendment does protect property rights, but no property rights would be involved under such a state of facts. It was not necessary in this case for the Missouri Supreme Court to pass upon any federal question. No federal question was involved. It was purely a question of fact. That is, whether or not under the reduction order the companies would be compelled to do business at a loss and thus have their property confiscated. The evidence shows that they will make an enormous profit with the reduction order in effect. The decision of the Missouri Supreme Court was on other matters than federal matters and the mere fact that an alleged federal question might be remotely involved is not sufficient for this court to assume jurisdiction.

If there is one matter finally and conclusively settled by this court it is there where a state decision rests on an independent ground, not involving a federal question and broad enough to maintain the judgment, this court will not assume jurisdiction. In this case the decision rests on purely independent grounds aside from any federal question, and that this court will not assume jurisdiction was said by Mr. Chief Justice Fuller in *California Powder Works* v. *Davis*, 151 U. S. l. c. 393:

"It is axiomatic that, in order to give this court jurisdiction on writ of error to the highest court of a state in which a decision in the suit could be had, it must appear affirmatively not only that a federal question was presented for decision by the highest court of the state having jurisdiction, but that its decision was necessary to the determination of the cause, and that it was actually decided or that the judgment as rendered could not have been given without deciding it. And where the decision complained of rests on an independent ground, not involving a federal question and broad enough to maintain the judgment, the writ of error will be dismissed by this court without considering any federal question that may also have been presented. *Eustis* v. *Bolles*, 150 U. S. 361."

This same rule is stated in a different way and is much more favorable to the State of Missouri by Mr. Justice Shiras in *Eustis* v. *Bolles*, 150 U. S. l. c. 366:

"It is settled law that, to give this court jurisdiction of a writ of error to a state court, it must appear affirmatively, not only that a federal question was presented for decision by the state court, but that its decision was necessary to the determination of the cause, and that it was actually decided adversely to the party claiming a right under the Federal laws or Constitution, or that the judgment as rendered could not have been given without deciding it. *Murdock* v. *Memphis*, 20 Wall. 590; *Cook County* v. *Calumet & Chicago Canal Co.*, 138 U. S. 635.

It is likewise settled law that, where the record discloses that if a question has been raised and decided adversely to a party claiming the benefit of a provision of the Constitution of laws of the United States, another question, not Federal, has been also raised and decided against such party,

and the decision of the latter question is sufficient, notwithstanding the Federal question, to sustain the judgment this court will not review the judgment.

In *Klinger* v. *Missouri*, 13 Wall. 257, 263, this court, through Mr. Justice Bradley, said: 'The rules which govern the action of this court in cases of this sort are well settled. Where it appears by the record that the judgment of the state court might have been based either upon a law which would raise a question of repugnancy to the Constitution, laws, or treaties of the United States, or upon some other independent ground, and it appears that the court did, in fact, base its judgment on such independent ground and not on the law raising the Federal question, this court will not take jurisdiction of the case, even though it might think the position of the state court an unsound one. But where it does not appear on which of the two grounds the judgment was based, then, if the independent ground on which it might have been based was a good and valid one, sufficient of itself to sustain the judgment, this court will not assume jurisdiction of the case; but if such independent ground was not a good and valid one, it will be presumed that the state court based its judgment on the law raising the Federal question, and this court will then take jurisdiction.' ''

In this case a construction of a Missouri statute was involved. There were also involved a great many questions of general law, such as the relevancy of certain testimony, whether the same was material or not. An examination of the opinion of the Supreme Court of Missouri will show that no federal question was involved, but that the decision was upon rules of general jurisprudence and broad enough to sustain the judgment without the raising of any federal question. In holding that in such cases this court will not as-

sume jurisdiction Mr. Justice Brown, speaking for this court in the case of *New Orleans* v. *New Orleans Water Works Company*, 142 U. S. l. c. 84, said:

> "In order to sustain the jurisdiction of this court upon the ground that a Federal question is presented, it should appear either that such question was apparent in the record, and that a decision was made thereon, or that, from the facts stated, such question must have arisen, and have been necessarily involved in the case. If it appear either that the decision of the state court was made upon rules of general jurisprudence, or that the case was disposed of upon other grounds, broad enough in themselves to sustain the judgment without considering the Federal question, and that such question was not necessarily involved, the jurisdiction of this court will not attach."

We have cited a great many other cases under this point, but as the court is so familiar with this rule we deem is unnecessary to quote from them. The most casual reading of this opinion of the Missouri Supreme Court will show that no federal question was involved, that no federal question was passed on, but that the decision was based on the general law of the land, and such being the case this court should not assume jurisdiction.

X.

Aside from the construction of Missouri Statutes, all other questions decided by the Missouri Supreme Court are questions of fact. This court will not undertake to review the decisions of the Supreme Court of Missouri on questions of fact.

Petitioners argue that questions of law are involved in this case the same as questions of fact.

With that statement we have no quarrel. All legal questions were decided adversely to these insurance companies, but not on federal grounds. The legal questions decided involved a construction of the Missouri statutes and nothing else. It is true that the construction requested by these insurance companies was denied, but that of itself does not raise a federal question. Otherwise, every time the supreme court of a state decides a case it could be brought to this court for review. The most casual reading of this record and opinion of the Supreme Court of Missouri will clearly show that no federal right asserted by petitioners was infringed upon.

Petitioners cite under this point a great many cases to the effect that where a court finds that rates were not confiscatory this is a finding of fact which should not necessarily preclude this court from determining whether or not a federal right was infringed upon. We do not disagree with counsel on this point, but what we insist is that outside of the construction of Missouri statutes in this opinion, the only other matters considered were matters of fact. It must first appear that a federal right has been denied and such does not appear in this case. Also where the law relating to a federal right is intermingled with findings of fact, in some instances, this court will say that a federal question is involved, but such is not the case here.

Outside of the construction of a Missouri statute in this case it was purely a question of fact whether the decision should be in favor of the insurance companies or in favor of the State of Missouri.

The insurance companies claim they took in so much money in Missouri; that they paid out so much money for losses and expenses. The state questioned every one of their figures and held that they had attempted to mislead the state. They were compelled by law to file sworn reports with Missouri each year showing their income and outgo, but when this case came on for trial they presented an entirely new set of figures much more to their advantage, so that it was purely a question of fact as to which set of figures was correct.

Whether they made profit or loss was purely a question of fact and the Missouri Supreme Court, after considering the testimony of both sides, found in favor of the State of Missouri. The rule is universal that this court will not assume jurisdiction where questions of fact are involved. Such being the case, this court should not assume jurisdiction.

Obviously, the Missouri decision does not rest upon a federal question and in the celebrated case of *Waters-Pierce Oil Company* v. *Texas*, 212 U. S. l. c. 97, Mr. Justice Day, speaking for this court, held that where questions of fact were involved, as in this case, the finding of the highest court of Texas would be sustained, and in stating the rule which is universal in this court said:

> "The jurisdiction of this court to review the proceedings of the state courts, as we have had frequent occasion to declare, is not that of a general reviewing court in error, but is limited to the specific instances of denials of Federal rights, whether those pertaining to the constitutionality

of Federal or state statutes, or to certain rights, immunities and privileges of Federal origin, specially set up in the state court and denied by the rulings and judgment of that court. Sec. 709, Rev. Stat. U. S. Nor does this court sit to review the findings of facts made in the state court, but accepts the findings of the court of the state upon matters of fact as conclusive, and is confined to a review of questions of Federal law within the jurisdiction conferred upon this court. *Quimby* v. *Boyd*, 128 U. S. 488; *Egan* v. *Hart*, 165 U. S. 188; *Dower* v. *Richards*, 151 U. S. 658; *Thayer* v. *Spratt*, 189 U. S. 346."

In *Smiley* v. *Kansas*, 196 U. S. l. c. 453, the suggestion was made that this court should consider questions of fact and determine for itself what the facts were, but in holding that this court would accept the findings of facts as made by the highest court of the state, Mr. Justice Brewer said:

"The verdict of the jury settles all questions of fact. In *Missouri, Kansas & T. Ry. Co.* v. *Haber*, 169 U. S. 613, 639, it is said: 'Much was said at the bar about the finding of the jury being against the evidence. We cannot enter upon such an inquiry. The facts must be taken as found by the jury, and this court can only consider whether the statute, as interpreted to the jury, was in violation of the Federal Constitution. *Chicago, Burlington & Quincy Railroad* v. *Chicago*, 166 U. S. 226, 242, 246.'"

To the same effect is the case of *King* v. *West Virginia*, 216 U. S. l. c. 100.

"The question is not open and we shall discuss it no more. It hardly is necessary to add that on a writ of error we do not deal with the facts, *Behn* v. *Campbell*, 205 U. S. 403, 407, and

therefore the decision that most of the tracts in question are not within the boundaries of the Morris grant disposes of King's right here."

XI.

In ordinary rate reduction cases the utility is entitled only to a reasonable return upon the property devoted to the use of the public. If the agency plants of petitioners in Missouri constitute property as alleged, devoted to the use of the public, and have a value of $4,265,302 as alleged, then perhaps petitioners are entitled to a reasonable return upon such value.

Petitioners state under this point that they have established agency plants and business in Missouri at great cost and expense; that the actual saleable value of such agency plants is $4,265,302 and suggest that for that reason they have property in Missouri devoted to the use of the public.

This point was not urged before the Supreme Court of Missouri and no consideration was given to it, but if now petitioners claim they have property in Missouri, then it may be that they are entitled to a return upon the value of such property. We only suggest this in view of petitioners injecting the question at this time.

In ordinary rate cases the rule is universal that a corporation is entitled to a reasonable return upon the property devoted to the use of the public. If petitioners are devoting this property to the use of the public in Missouri then perhaps they are entitled to a reasonable return upon the value of such property. If so, instead of asking a return upon more than $83,000,000, they are only entitled to a return upon a little more

than $4,000,000. Mr. Justice Hughes, 230 U. S. 352; 33 Supreme Court Reporter 754, states the rule thus:

> "The basis of calculation is the 'fair value of the property' used for the convenience of the public. *Smyth* v. *Ames*, 169 U. S. 546, 42 L. Ed. 849, 18 Sup. Ct. Rep. 418. Or, as it was *put in San Diego Land & Town Co.* v. *National City*, 174 U. S. 757, 43 L. Ed. 1161, 19 Sup. Ct. Rep. 804: 'What the company is entitled to demand, in order that it may have just compensation, is a fair return upon the reasonable value of the property at the time it is being used for the public.' *See also, San Diego Land & Town Co.* v. *Jasper, Supra; Willcox* v. *Consolidated Gas Co.*, 212 U. S. 19, 41, 53 L. Ed. 382, 395, 29 Sup. Ct. Rep. 192, 15 Ann. Cas. 1034."

One of the best reasoned cases as to what profit a corporation is entitled to make and as to how such profit shall be figured is the well known case of *Wilcox* v. *Consolidated Gas Co.*, 212 U. S. 19; 29 Sup. Ct. Rep. l. c. 195-199:

> "In order to determine the rate of return upon the reasonable value of the property at the time it is being used for the public, it, of course, becomes necessary to ascertain what that value is.
>
> Taking all facts into consideration, we concur with the court below on this question, and think complainant is entitled to 6 per cent on the fair value of its property devoted to the public use."

It will be observed that this court stated in the New York Gas case, *supra*, that a 6 per cent return on the fair value of the property devoted to the use of the public was a proper return. The Missouri Supreme Court, however, was much more generous to petitioners

and acquiesced with them in the allowance of an 8 per cent return. The court found that a profit of $6,680,-169 represented 8 per cent return, but that, in fact, petitioners made $8,681,964, or more than 2 million dollars more than an 8 per cent return, and that had the war tax been eliminated, which of course will not be paid in the future, petitioners earned in Missouri, during this test period, $9,310,087, or as the supreme court says: "About 40 per cent more than what was conceded to be a reasonable profit."

Obviously, therefore, with these companies earning nearly $3,000,000 more than an 8 per cent return in Missouri, the finding will have to be sustained. If petitioners have tangible property in Missouri worth $4,000,000 as they now assert, and are entitled to a return upon the value of this property in Missouri, then with an earning of more than $9,000,000 they have earned in excess of 100 per cent upon their property devoted to the use of the public in Missouri. The Missouri Supreme Court reaches the conclusion that the earnings of these companies in Missouri, during this period, were enormous, and concludes with this inquiry, which we adopt: "Was any business ever so generally prosperous? The plaintiffs, by this showing, every 5 years can quadruple their original investment and double their total accumulations, and at the same time pay as dividends 10 per cent per annum."

IN CONCLUSION.

It is suggested by petitioners that the merits of this case should strongly appeal to this court. With that statement we agree. Fire insurance companies in Missouri have been treated more than fair and have taken millions of dollars from the state. Their earnings at all times have been enormous. Prior to 1915 they operated under the anti-trust law. At that time they wanted a Rating Act, and it was prepared by them and the state department and was to their liking. Under it they applied for an increase in 1915 and secured it. Again they applied for an increase in 1919 and it was refused. Again they applied for an increase in 1920 and a flat 15 per cent increase was granted them. When they applied for these increases they applied on the basis as now contended for by Missouri, that is, premiums received, losses and expenses paid. On that basis they were granted increases. They never suggested during all of those years that this basis was improper and that consideration should only be given to premiums earned, losses incurred and expenses incurred. But when Missouri in 1922 suggested a 10 per cent reduction as against the 15 per cent increase granted them in 1920 they immediately rush into court and suggest that their method was wrong when they dealt with the state, and secured these increases, and that they now want the matter considered on an entirely new and erroneous basis.

As the Missouri Supreme Court points out, this was evidently an ingenious attempt on the part of skilled experts to secure an advantage over the State of Missouri. Having dealt with the state and secured increases at least three times on that method provided by the Missouri statute, it is now unfair for them to deal with the state on an entirely different basis, which was originated for the purpose of this law-suit. Every judge on the Missouri Supreme Bench decided this question against these insurance companies. While two judges dissented in part from the opinion, it was not on this point.

As the Missouri opinion points out, these companies earned more than a reasonable profit in Missouri and a careful reading of the Missouri opinion will show that the case was carefully considered and a masterful opinion written by a very able court. We respectfully insist that the opinion could only have been in favor of the State of Missouri, and we respectfully urge that it be adopted by this court.

Respectfully submitted,

North Todd Gentry,
Attorney-General,
State of Missouri,
Floyd E. Jacobs,
John T. Barker,
Attorneys for Respondent.